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Politics this week

Nov 11th 2004
From The Economist print edition

Arafat dies

Reuters

Yasser Arafat, the Palestinian leader, died in a hospital on the outskirts of Paris, a week after being flown from his compound in Ramallah on the West Bank. A funeral service is to be held in Cairo, but he will be buried in Ramallah.

See article

The Palestinian parliament's speaker will now hold the presidency for 60 days, pending an election. Mahmoud Abbas, also known as Abu Mazen, will become the senior figure in the **Palestine Liberation Organisation**, the umbrella group for all the secular Palestinian groups, while Ahmed Qurei, also known as Abu Alaa, continues as prime minister of the Palestinian Authority, which is supposed to govern most of the Palestinian territories in the Israeli-occupied West Bank and Gaza.

See article

Up to 15,000 American and Iraqi forces began a long-awaited assault on the rebel-held town of **Fallujah**. Some 3,000 Iraqi and foreign rebels, many of them Islamist zealots responsible for much of the insurgency in the country, were said to be holed up there. After three days, the Americans said they controlled over 70% of the town, for the loss of a dozen troops. Some Sunnis in Iyad Allawi's interim government resigned.

See article

The **Iranian** government appeared to accept a deal presented by Britain, France and Germany that would curb Iran's plans to build nuclear devices that could be used for military purposes.

See article

Bloody strife erupted in **Côte d'Ivoire** after government forces bombed a French base whose troops were trying to keep the peace between mainly Muslim northern rebels and the southern-based government of President Laurent Gbagbo. The French responded by destroying the small Ivorian airforce. That in turn prompted widespread anti-French rioting in Abidjan, the commercial capital.

See article

Representatives of the **Sudanese** government and Sudanese rebels, met in Nigeria's capital, Abuja, and agreed that the government would let aid agencies into the strife-ridden Darfur region and that the airspace above it would be closed to military aircraft.

See article

Reassembling the cabinet

George Bush began preparations for his second term. John Ashcroft, the controversial attorney-general, and Don Evans, the commerce secretary, both resigned for personal reasons. Alberto Gonzales, the White House legal counsel, will replace Mr Ashcroft.

See article

Conservative groups launched a campaign to stop **Arlen Specter**, a moderate Republican from Pennsylvania, from chairing the Senate Judiciary Committee when the new Congress begins in January. They fear he may not take a tough enough line on judicial nominations.

The trial by military commission of Osama bin Laden's former driver, held at **Guantánamo Bay**, was suspended after a federal judge ruled that the process was unconstitutional. The Justice Department said it would appeal.

See article

The Rand Corporation reported that compensation paid out by the government and insurance companies to victims of **September 11th** is at least $38.1 billion.

Negotiating with kidnappers

Japanese negotiators started a new round of talks in **North Korea** on the fate of Japanese nationals allegedly abducted by the North in the 1970s and 1980s.

Figures showed that **China's** industrial output slowed slightly in October, a sign that measures to tackle the overheating economy may be working.

Japan's navy was mobilised for the first time in five years to try to make a submarine, believed to be Chinese, come to the surface. The incident took place near Okinawa, an island south of the Japanese mainland.

India's main opposition party, the BJP, suspended one of its most prominent figures, Uma Bharti, a firebrand Hindu nun, and removed her from her party post of general secretary after a public row about tactics.

Sandinist gains

EPA

Nicaraguan voters delivered strong gains in local elections to the Sandinists, who ran the country during the *contra* war in the 1980s, raising the spectre of a Sandinist return to power two years hence.

See article

Ecuador's president, Lucio Gutiérrez, won a reprieve after six opposition legislators failed to show up for the vote to form a *comisión especialísima*, or “very special commission”, which will consider impeaching him for an alleged misuse of public funds.

See article

The **Chilean** army decided for the first time to accept institutional blame for human-rights abuses during General Augusto Pinochet's dictatorship, in an attempt to pre-empt an expected damning report on its role.

The head of a panel set up to organise new presidential elections in **Haiti** for December 2005 resigned, citing pressure to manipulate the process. She had opposed a scheme to buy $112m-worth of electronic-voting machines for a country with one of the world's least reliable electricity supplies.

Mexican police arrested René Bejarano, a former top aide to Andrés Manuel López Obrador, the mayor of Mexico City, in another in a series of blows to Mr Obrador's presidential ambitions.

Silvio's shuffle

Silvio Berlusconi, Italy's prime minister, picked Franco Frattini, his foreign minister, as **Italy's** new European Commissioner. He is expected to choose Gianfranco Fini, leader of the National Alliance party, as the new foreign minister; but the announcement was delayed by further rows within the governing coalition over planned tax cuts.

Belgium's appeals court confirmed a ban on the Vlaams Blok party for inciting racism. The far-right group, which has become the most popular party in Flanders, will now have to be re-formed under a new name.

See article

The **German** government hit a spot of bother after proposing and then hastily withdrawing plans to scrap a public holiday to mark German unity.

Last week's murder in **the Netherlands** of Theo van Gogh, a film-maker, by an Islamic militant, was followed by a series of attacks and counterattacks on mosques, Muslim schools and churches, and further arrests of terrorist suspects.

See article

AP

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Business this week

Nov 11th 2004
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Microsoft settles

Microsoft tried to ameliorate its antitrust problems by settling with two of its biggest opponents. Novell will get $536m and the Computer & Communications Industry Association an undisclosed sum for withdrawing their support from an EU case against the software giant. The CCIA also promised to drop an appeal against Microsoft's 2001 antitrust deal with the American government. But Novell pledged to continue a separate action and the EU promised to continue its pursuit of Microsoft.

A potential clash of media titans loomed. After **John Malone**, chairman of Liberty Media, said he would raise his stake in News Corp from 9% to 17%, **Rupert Murdoch** announced a “poison pill” to deter his rival. News Corp's boss said that if anyone took a holding of over 15% he would offer cheap shares to other investors to head off a hostile bid. Liberty claimed that it was, in fact, hoping to extend a mutually beneficial alliance.

See article

The board of **PeopleSoft** rejected an enhanced $9.2 billion bid from Oracle, a rival software firm. The two companies are now expected to settle their long-running battle in a proxy fight for shareholder support at PeopleSoft's annual meeting next year.

Trade beef

Transatlantic **trade relations** took a turn for the worse. The EU asked the WTO to rule against American and Canadian sanctions on goods worth $125m that were applied in retaliation for a ban on imports of hormone-treated beef into Europe. The countries reject the EU's scientific evidence for banning the beef on health grounds.

Meanwhile, the EU called for official talks with America over charges that a British firm was **dumping** specialist steel products. America has imposed tariffs of 126% on Firth Rixson's products; the EU says that the firm has not been allowed to defend the charge. The move is widely seen as a precursor to wider official action through the WTO.

Phoning abroad

British Telecom announced plans to boost its presence in international corporate communications. BT will pay $965m for Infonet, an American data-communications business, marking a return to the United States after Concert, the British firm's disastrous joint-venture with AT&T, collapsed in 2001.

In a victory for **internet-phone services**, America's Federal Communications Commission ruled that they should be regulated federally rather than at state level. The FCC fear that a hotch-potch of local rules would hold back development of the service.

California's regulators dropped opposition to a deal that will create America's biggest health insurer. **Anthem's** $16.5 billion acquisition of **WellPoint Health Networks** will be allowed to proceed after the firms promised to spend $265m on health schemes for the state's poorest residents.

Marks & Spencer said that profits plunged by 40% in the six months to October compared with a year ago, to £140m ($254m). The embattled British retailer also announced a management shake-up which

included the departure of six senior executives.

Unemployment insurance

Marsh & McLennan suffered the consequences of its involvement in a bid-rigging scandal that continues to dog the insurance industry. The world's leading insurance broker reported profits of just $21m in the latest quarter, a fall of 94% compared with a year ago, and said that 3,000 jobs would go, 5% of the total.

America's Securities and Exchange Commission proposed new rules to beef up **governance** at America's leading stock exchanges, including filing of quarterly reports with regulators and appointing a majority of independent directors. The SEC also invited comment on whether self-regulation should give way to a single watchdog.

Commerzbank, Germany's third-largest listed bank, said it would close most investment-banking operations abroad with the loss of 900 jobs. It is the latest German bank to scale back on global aspirations to concentrate on fighting foreign banks at home.

See article

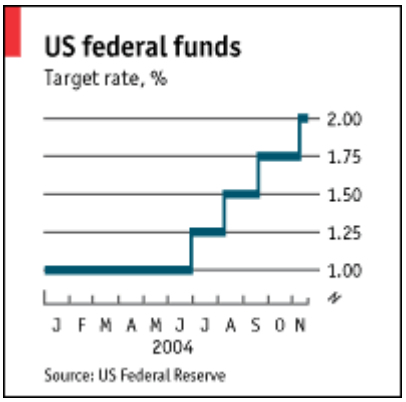
Cazenove, a small but influential British investment bank, finally made a deal with a big rival. It will start a joint-venture with **J.P. Morgan**, which will have the right to buy Cazenove outright in five years.

See article

Rates of change

In a widely expected move, America's Federal Reserve raised **interest rates** by a quarter of a percentage point to 2%. Meanwhile, the dollar briefly hit an all-time low against the euro of $1.30, as fears about the trade deficit—which, despite shrinking in September, is still near an all-time high—offset an improving job market and the rate hike.

See article



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Yasser Arafat

Exit Arafat

Nov 11th 2004
From The Economist print edition

With the right sort of succession, the Palestinians could benefit from the loss of their hero

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AFP

WHEN half the world lauds you as a statesman and the other half vilifies you as a terrorist, you know your passing will be controversial. But as the obituarists do battle over Yasser Arafat, politicians face more pressing business. Churlish though it sounds, the passing from the political scene of the Palestinian leader may be just what is needed to bring the “peace process” in the Middle East back to life.

The reason is simple. Mr Arafat's death on November 11th (see article) removed a man who, like it or not, had remained the unchallenged leader of the Palestinian people. Even the Americans and Israelis acknowledged that he was an irreplaceable symbol. For the past two years, however, neither government would have anything to do with him. Israel accused him of inciting the *intifada*, organising the very terror attacks which under the Oslo peace accords he had promised to prevent. George Bush expressed “disappointment” with a leader who had failed his own people. Whatever the justice of those allegations, the upshot was that the Palestinians could not do business with either of the countries on whom their hopes of independent statehood most depend.

Now, in principle, they can. For Mr Bush and Ariel Sharon, the animus against Mr Arafat was personal. Though they would not deal with him, neither ruled out talking to the Palestinian Authority. Both the Americans and the European Union had tried over the past two years to bypass the old man by building up his prime ministers. It was only after these efforts failed that Mr Sharon, claiming to have no peace partner, announced that Israel would be compelled to act unilaterally, notably by evacuating all Jewish settlements from the Gaza strip at a time and in a manner of its own choosing.

Time to call some bluffs

In Palestinian minds, Mr Sharon's refusal to talk to their leader has all along been nothing more than a pretext for avoiding a peace that would entail giving up the West Bank as well as Gaza. If so, this is therefore the moment for a new Palestinian leadership, preferably chosen by election, to call Mr Sharon's bluff (see article). Indeed, there are two reasons for thinking that Mr Arafat could hardly have timed his exit better.

The first is that Mr Arafat's exit coincides with the re-entrance of Mr Bush, at a time when Europeans and Arabs alike are imploring him to deliver in his second term the statehood he promised the Palestinians in his first. That is something he could not easily do while continuing to boycott the Palestinians' elected leader. The second is that Mr Arafat died at a time of extraordinary political turmoil inside Israel.

Though supposedly a super-hawk, Mr Sharon's plan to evacuate the Gaza strip has brought him into confrontation with Israel's entire settler movement and split his ruling Likud party. One of the strong arguments the settlers make, which resonates well beyond the settlers' natural supporters, is that his unilateral withdrawal from Gaza is even worse than the land-for-peace formula the right deplores: it is land for no peace. So although most Israelis tell pollsters that they consider it worth their while to pull out of Gaza in order to shorten their lines, they hardly relish the prospect. With Mr Arafat alive, it was assumed, the *intifada* would still continue.

A Palestinian Authority under new leadership now has an opportunity to alter the entire psychology of the conflict. Some of the Palestinians now thrusting themselves forward, notably Mahmoud Abbas (Abu Mazen), a former prime minister now elected as the new chairman of the Palestine Liberation Organisation, have made no secret of their belief that by launching a violent *intifada* after the failure of Bill Clinton's Camp David summit four years ago, the Palestinians made a calamitous mistake. Apart from the suffering this inflicted on both sides, the *intifada* destroyed the morale of Israel's peace camp and smashed the electoral prospects of Ehud Barak's Labour Party. The many Israelis who had long supported a historic compromise and a two-state solution felt duped and betrayed. And, like Mr Sharon, they tended to pin the blame on the person of Mr Arafat.

Nobody yet knows what sort of leadership a new set of Palestinian elections will produce. But if it is the pragmatists like Mr Abbas who come to the fore, the peace process can resume in earnest. Better still, it does not have to start back at square one. It can exploit the momentum of Mr Sharon's Gaza withdrawal by connecting this to a pre-existing peace plan, the international “road map” that is designed to lead to an independent Palestine at peace with the Jewish state.

A chance, but not an easy one

The road map has many virtues. It is already written, it has been signed by both sides, and it is approved of not only by the Americans but also by America's partners in the so-called “quartet”: the Russians, the European Union and the United Nations. Two things have been missing: a will to implement it and a clearer sign of the final dimensions of the future Palestine. Mr Bush could fill both gaps by appointing a high-level emissary to drive negotiations forward and by making it plain, as Mr Clinton did, that the Palestinians can expect a state based more or less on the pre-1967 borders (with some negotiated modifications and land-swaps), a share of Jerusalem, but no generalised “right of return” for the refugees of 1948.

However, the very first step is supposed to be a ceasefire. Though the Palestinians claim that it is Israel that undermines every truce, their own side faces the bigger test. What the road map demands is not just a truce but the disarming of the radical factions such as Hamas and Islamic Jihad and therefore, in effect, an end to the *intifada*. Since that is the very step that Mr Arafat seemed unable to take, his successors will not find it easy. On paper, the radical groups claim to believe in a fight to the finish and the destruction of the Jewish state. They may see Mr Arafat's death as a chance to increase their influence. By most accounts, however, the majority of Palestinians, like the majority of Israelis, prefer the peace option. The two peoples on each side of this conflict now face a moment of truth. A great prize awaits if the pragmatists succeed.

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America in Iraq

After Fallujah

Nov 11th 2004
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America still faces a war on many fronts

AP

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BY ALL accounts, America's marines have this week shown their usual lethal efficiency in Fallujah. To that extent, George Bush has cause to be satisfied with his decision to grab back the military initiative so soon after winning his second term in the White House. But Fallujah is only one front in the vicious anti-insurgency war America now finds itself fighting in Iraq. This will continue well beyond the marines' battle in Fallujah. Indeed, the very fact that Americans are having to fight so fiercely inside a major city, 18 months after liberating Iraq from Saddam Hussein, is a sign of how close Mr Bush's Iraq policy is teetering towards failure.

Under the UN's plan, Iraqis are supposed to elect a new government by the end of January. Many hopes rest on this poll taking place in peace and on time. And yet it is still far from clear whether this will be possible. As the fighting in Fallujah and other Sunni areas shows, the country is divided. A large number of Iraqis resents America's presence in their country and are willing to take up arms against it.

Since Fallujah was both a focus and sanctuary for this resistance, being deprived of it may weaken the insurgents' power for a while. But the insurgents showed even while the Fallujah battle raged that they were still able to strike in other parts of the “Sunni triangle” west of Baghdad, as well as in the capital itself. Meanwhile, military victory in Fallujah will extract a political price. Few hearts and minds are going to be turned America's way by the spectacle of infidel soldiers pounding an Arab town and winkling fighters out of its mosques. It is true that the conquest of Fallujah came at the behest of Iraq's own prime minister, Iyad Allawi, and only after the failure of many attempts to negotiate. But this will merely persuade a lot of Iraqis that the unelected Mr Allawi, lacking enough loyal soldiers of his own, is in the end a creature of the Americans.

It had to be done some time

So the attack was a mistake? No. In the months ahead, the world is going to have to get used to the idea that in Iraq almost any course of action—including, by the way, an early American departure—brings attendant dangers. Any government aspiring to rule Iraq would at some point have to wrest back a town that was in open mutiny. It might have been better to negotiate a compromise, of the sort that averted a

bloodbath in the besieged city of Najaf, holy to Iraq's Shia majority, in the summer. But the Americans did just that after the failure of their earlier, improvised assault on Fallujah last April—and the compromise broke down. It might have been better to wait until after January's election, so that Fallujah could have been stormed in the name of an elected government rather than a merely appointed one. But by preventing any possibility of Fallujah and similar Sunni towns from taking part in the election, that would have further alienated the Sunni minority.

What is needed now is prompt corrective action to persuade the Sunnis to take part in January's election. This will not be easy: one Sunni party, the Iraqi Islamic party, has already marched out of the interim government in protest. The country's Sunni president, Ghazi al-Yawar, distanced himself publicly from the Fallujah decision. And the Muslim Scholars' Board, a Sunni organisation with close ties to the insurgents, has called for a boycott of the poll. Yet such protests should not be taken altogether at face value. For Iraq's Sunni-based parties—indeed, for any Iraqi party—blaming and denouncing the occupier is just good pre-election politics. That is no doubt why Muqtada al-Sadr, the Shia cleric who led the summer's mutiny in Najaf, has added his voice to the protests even though he seems to favour the vote going ahead.

Will the Sunnis also come back on board? They may have little choice. Since they make up only about 20% of Iraq's population, they worry that an election will begin the process of transferring power to the country's Shias, who make up about 60%. The idea of a Shia ascendancy is anathema to many Sunni Arabs, especially those of Iraq, who enjoyed special privileges under Mr Hussein. But for all the scorn now heaped on Mr Bush's idea of democratising the Arab world, most other Iraqis seem eager to vote. The Shias' foremost spiritual leader, Ayatollah Ali al-Sistani, has been especially impatient. The 20% of Iraqis who are Kurds are also keen, having practised a rough-and-ready form of democracy for more than a decade in their quasi-independent northern enclave.

Even in Iraq, numbers count. Sunnis who have adopted the worldview of al-Qaeda will never take part in an election under American occupation. But plenty of secular Sunnis and some religious ones might be won over if their Shia and Kurdish brethren offer the right mix of incentives and guarantees. They will have an extra reason to co-operate if it becomes clear that America is winning the fight against the insurgency (which may require more troops), that the election will actually take place (which requires a big new push from the UN) and that they have something to gain by taking part (which requires artful negotiation by Mr Allawi). It is somewhere in this combination of tough military action, credible preparations for the vote and back-channel talks over a future constitution that the battle for Iraq might, even now, be winnable.

Given the dire consequences of failure—an American humiliation and the emergence of a terror-breeding failed state at the centre of the Middle East's oilfields—it is hardly any wonder that Iraq is an all-consuming anxiety in Washington. But it must not be the superpower's only regional preoccupation. Iran's nuclear ambitions are another danger (see article). And, of course, Mr Bush must find some way to seize the opportunity that Mr Arafat's death has opened up in Palestine, a conflict which Tony Blair, Britain's prime minister, called in Britain's House of Commons last week “the single most pressing political challenge in our world today”.

Even for a freshly re-elected president, success will be hard to achieve on so many fronts at once. But the effort must be made. The road to peace in Baghdad does not pass through Jerusalem—or vice versa, as some had claimed. But promoting peace in Palestine would help to shore up America's credibility in Iraq, at a time when it is being sorely tested.

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Europe and Iran

The nuclear route

Nov 11th 2004
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What prospects for a deal?

EPA

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EVERY diplomatic road has its twists. Whether towards success or failure can be hard to tell at the time. A tentative deal struck this week marks such a new turn in efforts by Britain, France and Germany to head off Iran's presumed nuclear-weapons ambitions and to rescue the Nuclear Non-Proliferation Treaty (NPT) from oblivion (see article).

Assuming it sticks, the agreement could avert an imminent rumpus. Despite months of American pressure, Iran's nefarious nuclear activities would be unlikely to be referred to the UN Security Council when the board of the International Atomic Energy Agency (IAEA), the UN's nuclear guardian, meets later this month. Yet if that is all it achieved, this week's deal would be a failure. Only concerted pressure brought Iran to the negotiating table. Unless that pressure is now kept up, by Europe and America, but also by Russia, Japan, China and others, there is no chance of levering Iran out of the bomb-seeking business.

All the deal does initially is suspend Iran's most dangerous nuclear activities—a point the European trio thought they had reached a year ago. They insisted then too that Iran halt work towards enriching uranium and producing plutonium. Iran claims such activities are merely to prepare fuel for future civilian nuclear reactors. But its 20 years of lies to IAEA inspectors have led most other governments, including the European three, to conclude that it secretly wants to use such materials as the fissile core of a bomb. Settling details of a comprehensive suspension now would lead on to a second element of the deal: a package of inducements that could lead to increased trade, enhanced political dialogue, even direct civilian nuclear assistance in energy and medical research. All this, the Europeans hope, will encourage Iran to give up its most troubling nuclear technologies for good.

The hope could yet prove futile. The deal on offer presupposes that Iran will negotiate in good faith. But then why has it built extensive, and expensive, enrichment facilities when it has only one power reactor, not yet operating, that will be supplied with Russian fuel, ask the sceptics? And although inspectors have not caught Iran busily at work on a bomb, they have caught it covering up nuclear experiments that amount to everything but.

For its part, Iran proclaims loudly that it has a “sovereign right” under the NPT to enrich uranium and make plutonium; any suspension agreed with the Europeans, it insists, will be only temporary. Yet whatever rights the treaty confers on those who sign it come only from meeting the overriding obligation not to pursue nuclear weapons. It is after all a non-proliferation treaty, not a nuclear-power generation treaty, and should not be allowed to become a bomb-cheats' charter. Iran's egregious violations of nuclear safeguards are already evidence enough of its failures in that regard. Indeed, this issue should be a deal-breaker. Given its record, unless Iran gives up the technologies that will soon bring it to the point of nuclear break-out from the NPT, it will remain a danger to all.

And if, against current odds, Iran decides to trade? Then America should be prepared to join in too. So far it has held aloof. After all, Iran refuses to recognise Israel's right even to exist and supports some terrorist groups. Yet the makings of a nuclear deal could unlock the possibility of other deals too. Success is very far from certain, but if there is to be an insurmountable obstacle along the way, let it be Iran

alone.

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Currencies

Where does the buck stop?

Nov 11th 2004
From The Economist print edition

The dollar is likely to fall further. This is creating more dilemmas for Europe than for America

Get article background

BY LIFTING interest rates by a quarter-point this week, America's Federal Reserve brought its key interest rate exactly in line with that in the euro area, at 2%. Unfortunately, there are few signs of any other convergence between the American and European economies. As America booms, growth in the euro area remains disappointing. It is hardly surprising that European policy makers are starting to fret about the latest rise in the euro, which hit a new life-time high of $1.30 this week against a weakening dollar. This movement in currencies reflects the biggest difference between the two economies: America runs a massive current-account deficit, the euro area is in surplus. If America's deficit is to shrink without triggering a recession, the dollar will need to fall further. But is it fair that so much of the burden of adjustment is falling on the euro?

Jean-Claude Trichet, the president of the European Central Bank (ECB), does not think so. Describing the rise in the euro against the dollar as “brutal” and “unwelcome”, he tried this week to stem the tide. Those same words helped to halt the euro's rise in January, but the markets doubt that the ECB is ready to put its money where its mouth is and actually intervene to prop up the dollar. Indeed, intervention by the ECB alone would probably fail. What really turned the dollar around early this year was massive intervention by the Bank of Japan. But with Japan's economy now in much stronger shape, it may be less eager to buy dollars. Meanwhile, it is now widely believed that both America's Treasury and the Fed would welcome a further fall in the dollar to help correct America's huge external deficit.

The greenback has dropped by 15% against a broad basket of currencies since its peak in early 2002, but it is still not cheap. After adjusting for inflation, the dollar's trade-weighted value remains close to its 30-year average. By some estimates the dollar may need to decline by another 20-40% (see article), but it needs to fall more evenly against other currencies. So far, the burden has fallen disproportionately on the euro, which has surged by 50% against the dollar since 2001, because Asian central banks have resisted a rise in their currencies. With a limited number of flexible currencies, the euro is taking most of the strain.

It would be better for the world economy if China and the other Asian economies allowed their exchange rates to rise. There are hopes that China may soon widen the band within which its currency is allowed to trade. It may also shift to pegging the yuan to a basket of currencies rather than just to the dollar, but a big revaluation seems unlikely in the near future.

Not that brutal

Should the ECB be concerned and, if so, what can it do about it? A stronger euro makes exports more expensive, which may explain why German exports fell during the third quarter of this year. Yet so far, European firms seem to be coping fairly well with a stronger currency, thanks in part to recent efforts to cut costs. Although, by most measures, the euro is already overvalued against the dollar, its overall strength tends to be exaggerated. The euro's trade-weighted value has risen by much less and today it is roughly the same as it was at its launch almost six years ago.

A strong currency could even be beneficial for Europe, by intensifying competitive pressures and thus speeding up economic reforms. A stronger euro is also helping to hold down inflation by reducing the

prices of imported goods, and so taking pressure off the ECB to lift interest rates. Oil prices have risen by much less in euro terms than in dollars. But what if the euro continues to climb? Some economists argue that if a stronger euro starts to harm economies in the region, then the ECB could cut interest rates. And yet with inflation still running above its target, the ECB will not be in a rush. And rightly so: real interest rates are already negative and the bank has raised the alarm about the recent rapid pace of growth in credit which could lead to unsustainable increases in asset prices, particularly in house prices. In both Japan in the late 1980s and America in the late 1990s, central banks held down interest rates because strong exchange rates were keeping inflation in check. The result was excessive credit growth which, in turn, brought price-bubbles in stockmarkets and property.

From the point of view of the world economy, a weaker dollar is clearly a good thing if it helps to shrink America's current-account deficit, thus reducing the risk of a future financial crisis. A stronger euro is arguably a small price to pay to avoid such a crisis. However, Europeans are right to protest. After years of profligacy by both America's consumers and its government—the prime reason for America's external deficit—it is surely America's economy, not Europe's, that should now be feeling rather more economic pain.

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Intellectual property

Monopolies of the mind

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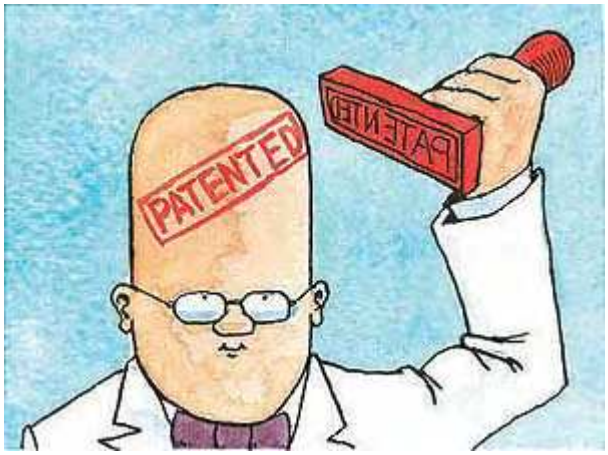
The world's patent systems need reform so that innovation can be properly rewarded



PATENTS, said Thomas Jefferson, should draw “a line between the things which are worth to the public the embarrassment of an exclusive patent, and those which are not.” As the value that society places on intellectual property has increased, that line has become murkier—and the cause of some embarrassment, too. Around the world, patent offices are being inundated with applications. In many cases, this represents the extraordinary inventiveness that is occurring in new fields such as the internet, genomics and nanotechnology. But another, less-acceptable reason for the flood is that patent offices have been too lax in granting patents, encouraging many firms to rush to patent as many, often dubious, ideas as possible in an effort to erect legal obstacles to competitors. The result has been a series of messy and expensive court battles, and growing doubts about the effectiveness of patent systems as a spur to innovation, just as their importance should be getting bigger (see article).

In 1998 America introduced so-called “business-method” patents, granting for the first time patent monopolies simply for new ways of doing business, many of which were not so new. This was a mistake. It not only ushered in a wave of new applications, but it is probably inhibiting, rather than encouraging, commercial innovation, which had never received, or needed, legal protection in the past. Europe has not, so far, made the same blunder, but the European Parliament is considering the easing of rules for innovations incorporated in software. This might have a similarly deleterious effect as business-method patents, because many of these have been simply the application of computers to long-established practices. In Japan, firms are winning large numbers of patents with extremely narrow claims, mostly to obfuscate what is new and so to ward off rivals. As more innovation happens in China and India, these problems are likely to spread there as well.

A crying need for discipline

There is an urgent need for patent offices to return to first principles. A patent is a government-granted temporary monopoly (patents in most countries are given about 20 years' protection) intended to reward innovators in exchange for a disclosure by the patent holder of how his invention works, thereby encouraging others to further innovation. The qualifying tests for patents are straightforward—that an idea be useful, novel and not obvious. Unfortunately most patent offices, swamped by applications that can run to thousands of pages and confronted by companies wielding teams of lawyers, are no longer applying these tests strictly or reliably. For example, in America, many experts believe that dubious patents abound, such as the notorious one for a “sealed crustless sandwich”. Of the few patents that are

re-examined by the Patent and Trademark Office itself, often after complaints from others, most are invalidated or their claims clipped down. The number of duplicate claims among patents is far too high. What happens in America matters globally, since it is the world's leading patent office, approving about 170,000 patents each year, half of which are granted to foreign applicants.

Europe's patent system is also in a mess in another regard: the quilt of national patent offices and languages means that the cost of obtaining a patent for the entire European Union is too high, a burden in particular on smaller firms and individual inventors. The European Patent Officemay award a patent, but the patent holder must then file certified translations at national patent offices to receive protection. Negotiations to simplify this have gone on for over a decade without success.

As a start, patent applications should be made public. In most countries they are, but in America this is the case only under certain circumstances, and after 18 months. More openness would encourage rivals to offer the overworked patent office evidence with which to judge whether an application is truly novel and non-obvious. Patent offices also need to collect and publish data about what happens once patents are granted—the rate at which they are challenged and how many are struck down. This would help to measure the quality of the patent system itself, and offer some way of evaluating whether it is working to promote innovation, or to impede it.

But most of all, patent offices need to find ways of applying standards more strictly. This would make patents more difficult to obtain. But that is only right. Patents are, after all, government-enforced monopolies and so, as Jefferson had it, there should be some “embarrassment” (and hesitation) in granting them.

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Côte d'Ivoire

Tempting chaos

Nov 11th 2004
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To avert a bitter conflict in Côte d'Ivoire, France needs help

FOR a vision of the country's future—should the current chaos in Côte d'Ivoire continue, as it well may—look west. In neighbouring Liberia and Sierra Leone, recently-ended wars have cost around half a million lives in 15 years and left millions beggared and bereaved. Only when the plunder ran low did the flames subside, making way for UN peacekeeping missions costing hundreds of millions of dollars; reconstruction will cost billions more. Having much further to fall, Côte d'Ivoire, west Africa's second-biggest economy, could burn for decades. That is a prospect worth avoiding (see article).

Apparently not to Laurent Gbagbo, the country's ruler—or at least not if it means his retirement. On November 4th, he launched an attack on the rebels who control the north of his country, breaking a two-year ceasefire. France, which has 4,600 troops in Côte d'Ivoire enforcing a peace agreement that it brokered, did not object. It was close to despair at both sides' failure to honour the agreement, which is supposed to deliver elections next year. Then Mr Gbagbo's troops killed nine French soldiers, prompting France to destroy almost the government's entire air force, thereby ending the attack. But Côte d'Ivoire is boiling. Armed mobs roam Abidjan, the commercial capital, looting white-owned property. French troops are besieged by thugs, and may have killed scores of them. South Africa's leader, Thabo Mbeki, has invited both sides to his country for emergency talks. But peace looks unlikely.

That France was prepared to give war a chance was wrong but understandable. It acted heroically when the rebels arose in September 2002, blocking their advance on Abidjan, and brokering a deal to allay the concerns of the marginalised northerners they represent. This was to include renegotiation of the country's criteria for citizenship and land rights, which currently exclude several million northerners descended from immigrant workers. Also to be renegotiated were the eligibility requirements for presidential candidates, which had excluded the champion of the north from two elections.

It was a sensible deal. But Mr Gbagbo, who could not hope to win an inclusive election, ensured that none of the necessary reforms took place. The rebels have meanwhile enriched themselves, reducing their desire to resuscitate the process. The world's biggest cocoa producer, Côte d'Ivoire is torn across the middle and increasingly lawless everywhere. In the north, there are few medical services bar those provided by European charities. In the west, near the border with Liberia, vicious local wars over minerals flicker and flare.

Now the neighbours need to help

France is to be congratulated for blocking the country's descent into chaos. But without urgent help, it may not hold firm for much longer. To prod Mr Gbagbo peacewards, it wants the UN to impose an arms embargo on the country, ban troublemakers from travel abroad, and seize their overseas assets. China, always queasy over sanctions, has insisted that Mr Gbagbo should be given until December 1st to push through the stipulated reforms, or face penalties. This would be a needless delay: Mr Gbagbo has already failed ample tests of his good faith.

But sanctions may not persuade Mr Gbagbo and his enemies to keep their words. In a region of porous borders, guns will flow. UN sanctions did not stop Charles Taylor, a tyrant of Liberia, trading arms for diamonds. Nor did they hinder his rebel rivals, who were armed by neighbouring Guinea, just as arms via Burkina Faso and Mali have helped Ivorian rebels.

Much will depend on its neighbours, if Côte d'Ivoire is to be spared a bitter war. Mr Gbagbo has portrayed France's intervention as a neo-colonial plot; it would be harder for him to do so if his brother Africans condemn him as they should. Mr Mbeki represents them through the African Union, but his progress is halting. On a fleeting visit this week to Abidjan, he feebly praised Mr Gbagbo's commitment to peace. If he needs steeling to offer sterner words, he should look west.

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Letters

Nov 11th 2004
From The Economist print edition

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Simple answers

SIR –"Complexity can kill", you warn us but after witnessing the American presidential election I would argue the opposite ("Keep it simple", October 30th). Politics in the United States, a profession already wrought with the superficial, has been reduced to yes and no answers. Abortion? No. God? Yes. Europe? No. Military defence? Yes. John Kerry? No, too hard to understand. George Bush? Yes, at least he's consistent.

Aesthetically pleasing the American mindset may be. However, in such complicated matters as diplomacy and nation-building complexity may kill but simplicity is worse.

Samantha Monk
Boston

SIR – Your plea to keep it simple hits a nerve, especially your complaint of the complexity of tax systems. America's runs to tens of millions of words. The Bible's simple rules on tithing, the churches' "tax" system, runs to 15 words in the book of Genesis. Alas, politicians cannot say anything in 15 words.

Bob Pratt
Wilmington, North Carolina

SIR – Amen to your stand against complexity. To quote an old maxim of aircraft designers: "simplicate and add lightness".

Alec Cawley
Newbury, Berkshire

Music's descending scale

SIR – I applaud your fact-based analysis attributing the decline of music sales to a dearth of new talent in today's musical graveyard ("Music's brighter future", October 30th). Yesterday's airwaves carried musicians displaying pure and simple virtuosity, while today's serve up "bands" offering technical wizardry and showmanship. True artists are discovered in clubs and bars, not manufactured in a studio. As soon as industry ostriches stop blaming piracy and assume accountability for their own business practices, listeners will re-engage and the labels' fortunes will recover.

Quint Barker
Harrison, New York

Irish bloodstock

SIR – Your survey of Ireland appropriately illustrates the recent success of the country's economy with a racing picture (October 16th). Unfortunately, you say "there have been betting and race-fixing scandals over the years". This is a careless and damaging generalisation. There have been remarkably few scandals. You refer to a dispute between John Magnier and Sir Alex Ferguson over the rights to a racehorse, Rock of Gibraltar. This is not a scandal. It was a disagreement over the terms of a business deal, which has since been resolved.

Having stumbled in running you then go on to take a heavy fall. You say: “the biggest scandal is that super-rich stud-farm owners benefit shamelessly from an exemption from both income and corporate taxes”. This is a shocking inaccuracy. The thoroughbred sector benefits solely from a tax exemption on the fees for stallion nominations. An independent report has established that the tax foregone is less than €4m ($5m) while the gross contribution from the sector is €37.5m. Other racing nations have complex systems of incentives for their breeders. The worldwide success of the Irish thoroughbred-breeding and racing sector is down to the excellence of our horses and the people who work with them.

Brian Kavanagh
Chief executive
Horse Racing Ireland
Kill, Ireland

SIR – You state that the Intel plant at Leixlip near Dublin was built on the site of a bankrupt stud farm. I am writing on behalf of the former owners of that site and stud farm to confirm that the stud farm was never bankrupt. It moved when it became expedient to sell the site. Considerable embarrassment was caused by your assertion and we would be grateful if you would set the record straight.

Gavin Bacon
Simmons & Simmons
London

Insurance claims

SIR – Your article on the probe of the insurance industry by Eliot Spitzer steers clear of any mention of the largest insurance companies and their incentives to participate in anti-competitive behaviour (“Just how rotten?”, October 23rd). Are they not in need of reform too? Clearly, there is a lack of proper oversight and governance when collusion with brokers is allowed to go on for long periods.

Henry Engler
Westport, Connecticut

SIR – You criticise state regulation but it is probably what most industries want. In the 1970s, corporate public-affairs officers were asking each other: “Which would you rather wrestle, 50 chimps or one gorilla?” The correct answer was: one gorilla.

Ted Kolderie
Saint Paul, Minnesota

Death on the ocean waves

SIR – In a new market for floating hotels you neglect to mention the ultimate in cost effectiveness (“Till death us do part”, October 30th). How much does burial at sea go for these days?

Michael Oster
New York

Oil-for-blood programme

SIR – You mock the view that “blood in Iraq is being spilt for oil” in your review of Michael Klare's book, “Blood and Oil” (“Crude arguments”, October 9th). You say that Mr Klare “counters the claim that the invasion of Iraq was ‘all about oil'.” In fact, the Iraq war was part of a Bush-Cheney strategy to secure what Mr Klare calls the “strategy of maximum extraction” of the Middle East's oil.

Jeffrey Sachs
Director
Earth Institute
Columbia University
New York

Dead man walking

SIR – Thomas Hoving and his brace of Dalmatians, who live in the apartment building opposite me in Manhattan, almost ran me down last week as they came out for their usual walk in Central Park ("Philistines flabbergasted", October 16th). Yet, in your piece on contemporary art in London, you refer to him as the "late" former director of New York's Metropolitan Museum of Art. For a dead man he still moves pretty well.

Ken Huszar
London

Repellent

SIR – Ben Coomb extols the benefits of Marmite in preventing the attention of mosquitoes (Letters, October 30th). Yuk. Surely he jests. Bring on the malaria, bring on the dengue fever. I'll take my chances with the mosquitoes.

Richard Kendon
Bangkok

SIR – I am reminded somewhat foggily of the approach to warding off mosquitoes taken during many years of living in the tropics. Rather than opt for a beer by-product, why not go for the real thing.

Toby Hallwood
London

SIR – Mr Coomb suggests that Marmite repels mosquitoes. I'm interested. Should I eat it or spread it on my skin?

Michael Morris
Bahrain

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American values

The triumph of the religious right

Nov 11th 2004 | WASHINGTON,DC
From The Economist print edition

Alamy

It may look like that, but liberals should think again before despairing

IN A novel, set in the 1960s, by John Kennedy Toole, “A Confederacy of Dunces”, the hero, Ignatius Reilly, goes to a gay party to drum up political support.

> In the centre of another knot [of guests] stood a lout in a black leather jacket who was teaching judo holds, to the great delight of his epicene students. “Oh, do teach me that,” someone near the wrestler screamed after an elegant guest had been twisted into an obscene position and then thrown to the floor to land with a crash of cuff-links and other, assorted jewelry. “Good gracious,” Ignatius spluttered. “I can see that we're going to have a great deal of trouble capturing the conservative rural red-neck Calvinist vote.”

Now, it seems, the conservative rural red-neck Calvinist vote has captured America. A plurality of voters, emerging from poll booths, said that the most important issue in the campaign had been “moral values”. It was not, it seemed, Iraq or the economy. And eight out of ten of these moralists voted for George Bush.

The thought that the anti-gay, anti-abortion Christian right had decided the election dismayed left-wing Americans. Garry Wills in the *New York Times* suggested that a fundamentalist Christian revival was in revolt against the traditions of the Enlightenment, on which the country is based. “I hope we all realise that, as of November 2nd, gay rights are officially dead. And that from here on we are going to be led even closer to the guillotine,” said Larry Kramer, a playwright and AIDS activist.

Secular Europeans wondered whether they and the Americans were now on different planets. The week before the election, Rocco Buttiglione had been forced to withdraw his nomination as a European Union commissioner because he had said that homosexuality was a sin, and that marriage exists for children and the protection of women. In America, he would probably have won Ohio.

Der Spiegel, Germany's most popular newsweekly, put the statue of liberty on its cover, blindfolded by an American flag. Britain's *Daily Mirror* asked, “How can 59,054,087 people be so DUMB?” And a contributor to *Pravda*, that bastion of religious expertise, claimed that “the Christian fundamentalists of America are the mirror image of the Taliban, both of which insult and deny their Gods.”

Hang on a moment. It is perfectly true that one of America's most overtly religious presidents of recent times has been re-elected with an increased majority. It is also true that 13 states this year passed state referendums banning gay marriage—in most cases by larger majorities than Mr Bush managed—and that a plurality of American voters put “moral values” at the top of their list of concerns.

A moral majority? Not really

But they hardly formed a moral majority. Look at the figures: the moralists' share of the electorate was only 22%, just two points more than the share of those who cited the economy, and three points more than those who nominated terrorism as the top priority. A few points difference (and the exit polls are, after all, not entirely reliable) and everyone would have been saying the election was about jobs or Iraq.

Moreover, that 22% share is much lower than it was in the two previous presidential elections, in 2000 and 1996. Then, 35% and 40%, respectively, put moral or ethical issues top, and a further 14% and 9% put abortion first, an option that was not given in 2004. Thus, in those two elections, about half the electorate said they voted on moral matters; this time, only a fifth did.

Of course, in those previous elections there was no war on terrorism, nor had there just been a recession. So one could argue that it was remarkable that even a fifth of voters were still concerned about moral matters when so many other big issues were at stake. Maybe, but all that this means is that the war on terrorism has not fundamentally altered, or made irrelevant, the cultural, moral and religious divisions that have polarised America for so long.

A church-going land

It is also important to judge the religious-moral vote against the background of American religiosity in general. America is traditionally much more religious than any European country, with 80% of Americans saying they believe in God and 60% agreeing that “religion plays an important part in my life”.

What may be changing is that the country is getting a little more intense in its religious beliefs. Also, and this could be more important, it is becoming more willing to tolerate religious involvement in the public sphere. A study by the Pew Research Centre reported that the number of those who “agree strongly” with core items of Christian dogma rose substantially between 1965 and 2003. So did the number of those who believe that there are clear guidelines about good and evil, and that these guidelines apply regardless of circumstances. Gallup polls in the 1960s found that over half of all Americans thought that churches should not be involved in politics. Now, over half think that they can be.

At the same time, alongside all these signs of more intense religiosity, there are indications of mellowing and tolerance. Support for interracial dating has virtually doubled since 1987; discrimination against people with HIV/AIDS has become socially unacceptable; tolerance for gays in public life has risen by half—though gay marriage is still seen as a totally different matter. Americans may be holding tenaciously to a strict view of personal morality, but they say that they do not want to impose their views on others (abortion seems to be the big exception).

The fact that there was a substantial religious-moral vote is not by itself evidence of a political breakthrough by religious conservatives. Nor is it necessarily a sign of growing intolerance. The real question is whether there was anything new about what happened last week that might pave the way for such things to happen in the future. The answer is yes, though not quite in the way you might expect.

In 2000, 15m evangelical Protestants voted. They accounted for 23% of the electorate, and 71% of them voted for Mr Bush. This time, estimates Luis Lugo, the director of the Pew Forum on Religion and Public Life, they again accounted for about 23% of the electorate—which means that evangelicals did not increase their share of the vote. But overall turnout was much higher, and 78% of the evangelicals who voted, voted for Mr Bush. That works out at roughly 3.5m extra votes for him. Mr Bush's total vote rose by 9m (from 50.5m in 2000 to 59.5m), so evangelical Protestants alone accounted for more than a third of his increased vote.

In close association

Thus, the election revealed that though the evangelical share of the electorate has not increased, evangelicals have become much more important to the Republican Party. According to a study for the Pew Forum by John Green of the University of Akron, Ohio, the proportion of evangelicals calling themselves Republicans has risen from 48% to 56% over the past 12 years, making them among the most solid segments of the party's base.

This close association between party and evangelicals took a lock-step forward during the campaign. Mr Bush's chief policy adviser and campaign chairman held weekly telephone conversations with prominent evangelical Christians, such as Jim Dobson, the head of Focus on the Family, and the Rev Richard Land of the Southern Baptist Convention. Ralph Reed, formerly the executive director of the Christian Coalition, became the campaign's regional co-ordinator for the south-east—a move that encapsulates the integration of evangelical voters into the party.

Hitherto, evangelical Protestants have been the objects of Republican outreach. This time, they took the initiative themselves, asking for and distributing voter registration cards and collecting the signatures required to put anti-gay-marriage initiatives on the ballot. As the church organisers tell it, the Republican Party was left playing catch-up.

A leaderless lot

The campaign also revealed how decentralised the evangelical movement is. There are respected figures, of course, such as Mr Dobson, and there are self-appointed prophets, such as Pat Robertson. But these people have no official institutional standing, and only limited moral authority. The evangelical involvement in politics was largely the product of grass-roots organising and bottom-up effort. As we will see, this could have implications for how much of their agenda is adopted in practice.

Remember, too, that the religious right and religious America are far from being the same things; Mr Bush's moral majority depended on the votes of other religious groups as well. Catholics, with 27% of voters, are more numerous than evangelicals, and, unusually this year, the Republican candidate won a majority of the Catholic vote (52% against 47%).

Though Mr Bush did especially well among white Catholics and those who attended Mass regularly, he also increased his share of the Hispanic Catholic vote from 31% in 2000 to 42%. This alone accounts for the inroads he made into the Hispanic vote, which has traditionally gone to Democrats by two to one. In all, calculates Mr Lugo, 3.5m more Catholics voted for Mr Bush in 2004 than in 2000. Thus, they were as important to his increased majority as evangelical Protestants were.

In God's country

Public opinion by religious affiliation, %*

	Evangelical Protestants			Mainline Protestants			Latino Protestants	Black Protestants	Catholic	
	Traditionalist	Centrist	Modernist	Traditionalist	Centrist	Modernist			Traditionalist	Centris
Religion is important to political thinking	81	41	21	56	29	15	51	57	50	22
Organised religious groups should stay out of politics	25	43	53	35	49	61	40	35	38	53
Government should help the disadvantaged	52	57	62	56	47	55	65	60	52	59
US should support Israel over the Palestinians	64	45	28	43	34	22	37	24	43	30
Fighting AIDS abroad should be a high priority	53	61	68	61	61	68	76	81	59	60
Favour traditional marriage†	89	67	42	72	44	29	71	72	71	52
Support gay rights	36	50	63	44	62	73	47	40	51	39

Source: Pew Forum on Religion and Public Life

*March-May 2004 †Question asked in relation to civil uni

This points to another new development. The election seems to have consolidated the tendency of the most observant members of any church, regardless of denomination, to vote Republican. During the campaign, a debate erupted among Catholics over John Kerry's support for abortion rights. Orthodox Catholics condemned his stance and one bishop even said he would deny the candidate communion (as a Catholic himself, Mr Kerry opposed abortion, but did not back anti-abortion laws). “Progressive” Catholics defended him, but the election returns suggest that the orthodox position won out. That seems characteristic of all denominations.

Mr Green subdivides each church into three groups (see table): traditionalists, centrists and modernists,

according to the intensity of belief. Traditionalists believe in church doctrine and go to church once a week or more; modernists are more relaxed. The three most Republican groups are traditionalist evangelicals, traditionalist mainline Protestants and traditionalist Catholics. Modernists lean towards the Democrats.

The election returns are consistent with this: people who go to church once a week or more voted for Mr Bush by nearly two to one. This seems to supersede the historical pattern, whereby evangelicals have tended to vote Republican, Catholics Democratic and mainline Protestants (Lutherans, Methodists) have split their vote.

The implication of these findings is that Mr Bush's moral majority is not, as is often thought, just a bunch of right-wing evangelical Christians. Rather, it consists of traditionalist and observant church-goers of every kind: Catholic and mainline Protestant, as well as evangelicals, Mormons, Sign Followers, you name it. Meanwhile, modernist evangelicals (yes, there are a few) tend to be Democratic.

What happens next?

The big question for the next four years is what the traditionalist constituency will demand of Mr Bush, and whether he will give it what it wants.

Already, self-appointed church leaders are queuing up to claim credit for the election victory and to insist on a bigger role in government. Mr Dobson told ABC's “This Week” programme that “this president has two years, or more broadly the Republican Party has two years, to implement those policies, or certainly four, or I believe they'll pay a price in the next election.”

There is no shortage of politicians, holding some of the more extreme views of the Christian right, who can be counted on to back the church leaders to the hilt. Tom Coburn, the new senator from Oklahoma, has called not just for outlawing abortion but for the death penalty for doctors who break such a law. Another new senator, John Thune of South Dakota, is a creationist. A third, Jim DeMint of South Carolina, has said single mothers should not teach in schools. Evangelicals are already bringing test cases to ensure that school textbooks include creationism and censor gay marriage.

Such local efforts have been common for years. What now matter are the country-wide political views of Mr Bush's traditionalist constituency. On the face of it, these Bush-leaning traditionalists come from central casting: conservative politically, rigid religiously, willing to mix up church and state. According to Mr Green's survey, nine out of ten of them say that the president should have strong religious beliefs, and two-thirds of them also believe that religious groups should involve themselves in politics.

AP

Voting under the cross

Yet the picture is more complicated than this makes it sound. For instance, in all the religious groups substantial majorities agree that the disadvantaged need government help “to obtain their rightful place in America”.

All favour increasing anti-poverty programmes, even if it means higher taxes. All support stricter environmental regulation. Large majorities say that America should give a high priority to fighting HIV/AIDS abroad. Religious conservatives have been among the strongest backers of intervening in Sudan and increasing AIDS spending in poor countries. If the Bush administration wanted to, it could find plenty of religious support for increased welfare programmes, tougher environmental standards and more foreign aid.

The differences between the religious groups are equally striking. The Protestant traditionalists favour less government spending. But all the Catholics—traditionalist, mainline and modernist alike—favour more.

Traditionalist evangelicals are usually the odd men out. Fully 81% of them say that religion is important to their political thinking—far more than any other group. They are the only ones to rate cultural issues as more important than economic or foreign-policy ones. They are the most opposed to abortion (though 52% say it should be legal in some circumstances) and the most opposed to gay marriage (though 36%

say they support gay rights). They also hold highly distinctive foreign-policy views: seven in ten say America has a special role in the world and two-thirds think America should support Israel in its conflict with the Palestinians.

He need not be trapped

Will the new importance of the traditionalist evangelical vote succeed in driving the president in the direction that many of these voters want? Not necessarily. The variety of conservative religious opinion means that Mr Bush need not be trapped by one important wing of his religious base, even if he will certainly not want to neglect it.

For example, the evangelicals' Zionist views are offset by the more even-handed positions of Catholics and mainline Protestants, implying that the president could try to restart the Middle East peace process without risking the wrath of his whole religious constituency. And because the evangelical churches are decentralised, and somewhat leaderless at the national level, it will be hard for any populist to mobilise them against a president they like and respect.

Attempts to ram conservative social policies into law look inevitable. They include the federal amendment banning gay marriage, though this is an uphill struggle that failed by 19 votes in the Senate last time round. Moreover, on the eve of the election, Mr Bush came out in favour of civil unions, which more than half the population, including many religious conservatives, favour. They also include extending a ban on “partial-birth abortion” to cover all third-trimester abortions, and, most important, appointing conservative judges to any Supreme Court vacancies.

This week there was a sign of what may be to come when Republicans threatened to strip Senator Arlen Specter of the chairmanship of the committee that oversees Supreme Court nominations after he said that staunch opponents of abortion were unlikely to be confirmed.

For opponents of Mr Bush, and also for many socially liberal Republicans, the election results and the trumpeted evangelical ambitions point to a big reversal: the victory of aggressive social conservatism over the small-government tradition in which morality is not legislated. It could, indeed, turn out to be something like this, but it need not. The wide variety of different opinions held by Mr Bush's religious supporters give the president, and his new administration, a lot of leeway, if they choose to look for it.

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Economic policy

From slogan to legacy

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From The Economist print edition

Getty

George Bush has an ambitious economic agenda. Can he deliver?

IN CASE anyone doubted the scale of George Bush's ambition for his second term, his first post-election press conference on November 4th dispelled it. The president's to-do list was long and bold. He wants to clean up unfinished business from the first term (such as tort reform) and expand his existing achievements (extending the No Child Left Behind education reform to high schools). But top of the list was tackling two economic juggernauts: Social Security (the public-pension system) and the tax code.

Mr Bush's determination was palpable “I earned capital in the campaign,” he explained, “and now I intend to spend it.” Does he have any hope of success?

Judging from the buzz in Washington, DC, Social Security tops the agenda. The problem is obvious. The looming retirement of the baby boomers will put America's pay-as-you-go public-pension system under increasing pressure. Social Security actually poses a smaller financial headache than Medicare, the health-care system for the old. But fixing Social Security would be a big step towards dealing with America's long-term fiscal problems.

Mr Bush first talked about reforming Social Security in the 2000 campaign and he appointed a commission to offer specific proposals in 2001. Yet his vision has never gone further than broad principles: creating individual accounts into which younger workers can divert some of their payroll contributions; not raising taxes; and not cutting benefits for existing retirees. Mr Bush has avoided two tougher but essential questions: whether (and how much) to cut promised benefits for today's workers; and how to pay the steep transition costs of shifting from today's system to one based on private accounts.

As so often, the choice is between political pain and economic profligacy. Shifting to private accounts from pay-go would cost money in the short term. The government gets in more money than it has to pay out (and uses the extra cash for normal spending). Given Mr Bush's unwillingness to cut benefits for today's retirees or to raise payroll taxes, he would have to cover the shortfall caused by the diversion of payroll taxes into private accounts by cutting spending elsewhere or, far more likely, borrowing. The bigger the accounts, the greater the borrowing.

Advocates of individual accounts point out that this borrowing is simply turning an implicit liability (the government's promise to pay future pensions to workers) into an explicit liability (increased government borrowing today). That is true, up to a point. Promises to pay future pensions are a little easier to break than defaulting on government bonds. And it is not clear that financial markets have priced in America's huge future fiscal liabilities, so a big increase in explicit borrowing could push up interest rates and scare away foreign investors. America is already running a budget deficit of almost 4% of GDP and the dollar is sliding.

The simplest way to reduce those implicit liabilities is to reduce the promised benefits. For instance, indexing future pensions to prices rather than to wages, as they are now, would virtually eliminate Social Security's actuarial deficit. But reduced benefits would be hard to sell politically.

Washington's pro-privatisation advocates are split. The “prudent” camp argues that the initial diversion to private accounts must be modest and combined with an explicit reduction in future pension benefits. They often cite a proposal from Mr Bush's commission, which would allow people to divert up to 4% of their payroll taxes to an account (up to a $1,000 cap) and from 2009 it would index all pensions to prices. This plan, said to have adherents within the administration, would require around $2 trillion of extra borrowing over the next decade.

The “radical” camp wants larger private accounts, no benefit cuts and big borrowing to pay for the transition. A law proposed by Senator John Sununu and Congressman Peter Ryan would allow people to pay on average half their payroll taxes into private accounts; there would be no cuts in their promised pensions (the assumption being that the private accounts would outperform the benefits promised by the government). Paying for such a huge shift would cost $3.6 trillion over the next decade alone; the cash would come from big cuts elsewhere in the budget, increasing tax revenue and lots of borrowing.

Mr Bush may decide to leave the choice between radicalism and prudence to Congress. In his first term, he sometimes sent detailed plans to Congress (his first tax cut, for instance). But Michael Tanner, a pensions expert at the Cato Institute, reckons Mr Bush will lay out principles and “let Congress deal with the sausage-making part” (as he did with Medicare).

That could be a problem. Republicans are likely to come up with a host of different proposals for reform. And there are still some Republican leaders in the House who are wary of Social Security reform, fearing it can only lose them votes in the 2006 mid-term elections. The Democrats do not seem inclined to help. Harry Reid, their probable new leader in the Senate, says privatisation would “destroy Social Security as we know it.” And some leading Democratic pension-reformers, such as Charles Stenholm from Texas, have just been booted out of Congress.

Despite this, a resolute Mr Bush could well deliver some form of pensions reform next year. Tax reform, by contrast, looks in roughly the same state that Social Security was four years ago. Once again, Mr Bush has laid out some broad principles: he wants a simpler, fairer tax code that will encourage saving and reward risk; he wants to keep deductions for mortgages and charitable giving; and reform should be revenue-neutral. As with Social Security in 2000, he has promised a commission to look at reform options.

The radical option

Some radicals hope for dramatic change—to a sales tax or a flat tax for instance. More realistic reformers yearn for a repeat of Ronald Reagan's big second-term tax-reform package in 1986, which cut tax rates and broadened the tax base.

Even that looks unlikely. This administration has done little detailed analysis of what tax reform might imply (and a blue-ribbon commission is unlikely to help much on that score). And Mr Bush's willingness to delegate to Congress could be a mistake: tax-reform laws written on Capitol Hill (like the recent corporate-tax bill) are an open invitation to lobbyists.

There will be pressures for some reform. The alternative minimum tax, originally designed to stop rich people claiming excessive deductions, will hit millions more Americans over the next few years. Fixing the AMT offers the chance for some base-broadening in return, for instance by getting rid of the deductibility of state income taxes (which would also punish high-tax liberal states, such as New York).

In his first term, Mr Bush tried to pursue tax reform through tax cuts. He shifted the tax code away from

taxing capital simply by cutting taxes on capital. He may try to do the same (for instance by expanding tax-free savings accounts), but he is constrained by the grim fiscal reality. Bruce Bartlett, a conservative tax analyst, reckons that “tax reform will have to take place in the context of raising taxes rather than cutting them.” In 1986, Reagan's tax reform was ostensibly revenue-neutral, but was followed by a tax hike the next year.

In truth, both Social Security and tax reform may depend on outside events. Serious reform must be done in the next year or so, before Mr Bush becomes a lame-duck president. And his economic agenda will be affected by non-economic battles, such as, say, bruising battles with Congress over conservative judges and gay marriage. And there is the economy itself. Sharply rising interest rates and a plummeting dollar, for instance, would darken the prospects for big borrowing to fund private accounts. His big bold plans might suddenly seem reckless—though that has seldom stopped Mr Bush in the past.

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The new guard

One, two...

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A new attorney-general and a new commerce secretary. And that's it?

AP

Farewell, Mr Ashcroft

THE redesign of George Bush's cabinet has begun. He has chosen his Texas friend and the current chief counsel in the White House, Alberto Gonzales, to replace John Ashcroft as attorney-general. Don Evans, the commerce secretary, often called the president's best friend, is also going. Neither resignation is a surprise: Mr Ashcroft has been suffering from pancreatitis (he had his gall bladder removed earlier this year) and Mr Evans's yearning to go home to Texas is well-known.

If Mr Gonzales passes muster with Congress, Mr Bush will earn a feather in his cap for appointing the first Latino attorney-general, a Mexican American. On the other hand, Mr Gonzales has not only defended the policy of detaining terrorism suspects indefinitely and without access to the courts (see article), but he also wrote a memo laying out a case for getting round anti-torture laws.

Mr Gonzales shares a history with the president that goes back at least a decade. He served under Mr Bush when the present president was governor of Texas; Mr Bush then put him on the state's Supreme Court, where he served for two years before joining Mr Bush in the White House. Mr Ashcroft was never so close to the president (he was not even Mr Bush's first choice for the job). The gospel-singing attorney-general is a part of the vigorous Christian movement that is now such an important part of the Republican coalition. Indeed, he was the highest-ranking politician this group has ever had. The move may be connected to Mr Bush's plans for the Supreme Court. Mr Gonzales had been widely tipped as a possible nominee, perhaps to replace the ailing chief justice, William Rehnquist. But conservatives disliked his views on abortion: while on the Texas Supreme Court, he allowed some exceptions to rules requiring teenagers seeking abortions to tell their parents. With Mr Gonzales out of the running, Mr Bush may have opened the way for a more pro-life nominee.

As *The Economist* went to press, the White House had yet to announce a successor to Mr Evans in the less important post of commerce secretary. One possibility is Mercer Reynolds, a Cincinnati businessman who raised a lot of money for the Bush-Cheney campaign. Mr Bush likes hiring people of proven loyalty. Mr Evans had helped Mr Bush in an unsuccessful run for Congress in 1978, and was his main fund-raiser in the 2000 presidential race. Although not as close to the president as Mr Evans, Mr Reynolds raised more than $260m for Mr Bush's re-election—and, years ago, helped him to get his stake in the Texas Rangers baseball team.

What next? Mr Ashcroft's and Mr Evans's resignations seem genuinely voluntary; the two men were

driven by bad health in one case, weariness in the other. There remain deeper questions about who, in the second Bush term, should be running the Defence Department, the State Department and maybe the National Security Council. There are plenty of people who say the president should also be looking for a heavyweight to give more punch to his economics team. But so far, he seems bad at sacking people. The only notable defenestration has been Paul O' Neill, and the gaffe-prone treasury secretary was hardly rushed to the door.

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A new California?

Arnold the Bold

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His state is pro-everything, he promises

NEVER doubt the salesmanship of Arnold Schwarzenegger. This week, the Golden State's governor was in Tokyo letting “Japan and the rest of the world know that...this is a new California. We are going to promote California as pro-business, pro-environment and pro-workers.”

California's tax receipts never having recovered from the dotcom bust, and with a likely budget deficit of $7 billion next year, a bit of business-luring promotion is understandable. But, one year into his tenure, is the salesman's product as good as his pitch? According to the non-partisan Milken Institute, California's business climate is still far from benign. Electricity costs are higher than in any other state except Hawaii; only four states have higher labour costs and more expensive office and industrial space. All in all, California is the second-dearest state for business.

Even so, the Gubernator's optimism (“fantastic” is his favourite word) is not entirely far-fetched. His pro-business words have been backed up by deeds. In short order he has reformed the system of workers' compensation; vetoed a rise in the minimum wage (whose purchasing power has fallen by 28% since 1968); and lobbied successfully against a ballot proposition requiring all firms with more than 20 employees to provide health insurance.

Equally successful was the governor's lobbying in favour of Proposition 64, which limits private prosecutions under California's “Unfair Business Competition Law” by requiring proof of loss or damage before any prosecution. This dismays the Sierra Club and other groups which, for decades, have been able to use the unfair-business law—unique to California—to protect consumers and prosecute polluters (oil companies, for example, were sued for polluting drinking water). But the victory of Proposition 64 delights many businessmen, who saw the law as an open invitation for “shakedown lawsuits” in a state with some 197,000 lawyers.

Will Proposition 64 really improve California's business climate? It clearly will not hurt it. Jeff Scott, of Greenberg Traurig, a law firm, calls it “a pretty big deal”. Even for large businesses, “the exposure can be enormous”; for small ones, the shakedown can be fatal. As Ross DeVol, a Milken Institute economist, points out, small businesses are vital in making California the top state for “new business job-growth”—and a lot of those businesses belong to Latino immigrants.

In the end, though, even Mr Schwarzenegger will need legislative help in lightening the burden on business. That means the Republican governor will need to work with the Democratic majority in the legislature, whom he called “girlie-men” during the negotiations for this year's budget.

Hence, perhaps, the mini-reshuffle of the governor's cabinet. Out as finance director goes Donna Arduin, a hardline budget-cruncher; in comes Tom Campbell, dean of Berkeley's business school and as Republican-lite as his new boss. Add the appointment as Mr Schwarzenegger's cabinet secretary of the versatile Terry Tamminen (he speaks German, Dutch and Spanish and has written a play on the life of Shakespeare), and the Schwarzenegger team begins to look more Democrat-friendly. But not too friendly. Asked last week if he would listen to Democratic proposals to raise taxes, the governor replied: “Why would I listen to losers?”

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The Guantánamo detainees

Here's to you, Mr Robertson

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A federal judge halts the first military "trial" of an al-Qaeda suspect

MIGHT the special "military commissions" at Guantánamo Bay have to be scrapped? On November 8th, Judge James Robertson of the US District Court in Washington, DC, halted the trial of Salim Ahmed Hamdan, after ruling that a "competent tribunal" must first decide whether Osama bin Laden's driver qualified as a prisoner-of-war (POW) under the Geneva Conventions. The judge also said the rules of the tribunal must conform with America's Uniform Code of Military Justice.

The Bush administration claims the 550 suspects at Guantánamo are "unlawful enemy combatants"—outside both the Geneva Conventions and American law. Last summer, however, the Supreme Court ruled that the Guantánamo detainees had the right to challenge their detention in the American courts. The Pentagon then set up "military review panels" to examine whether the detainees should be released; of 300 cases reviewed, only one has resulted in somebody being set free.

The Geneva rules say anyone captured in battle must be treated as a POW until his status has been properly determined by a competent tribunal. A POW can be interned "until the cessation of hostilities", but is otherwise subject to the same laws as those applied to the detaining power's soldiers. He famously need give only his name, rank and so on.

The Pentagon has studiously ignored Geneva. The military review panel, which Mr Hamdan went through first, did not even consider the POW question. The military commission, where he is being tried, bears little resemblance to a regular court martial. The five-member commission acts as both judge and jury, applies lower standards of evidence and allows no appeal to civilian courts.

The commissions have brought protests from foreign governments, including Britain's. Even the military lawyers appointed to defend Mr Hamdan and the other three detainees so far indicted have denounced them as "unfair". Mr Hamdan's petition is the first of 60 challenges in America's civilian courts on behalf of Guantánamo detainees arguing that the commissions are illegal.

Judge Robertson is only the first stage of the judicial ladder. Predictably, his ruling has been hailed by the likes of Anthony Romero, who is head of the American Civil Liberties Union, for showing how "the fight against terrorism does not give the government licence to disregard domestic and international law". The Justice Department is appealing against a decision "which puts terrorism on the same legal footing as legitimate methods of waging war". The case could well go to the Supreme Court—another reason for George Bush to look carefully at that body.

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Bill Clinton's library

Trailer-home chic

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AP

Put it on wheels, Hill. We're out of here

Elvis, Bono, Café 42: steel yourself

PASSERS-BY seem to feel the same way about the William J. Clinton Presidential Centre. They say the building, a mammoth modern glass rectangle, resembles an expensive mobile home. Not exactly what Bill Clinton wants to hear about his $165m shrine to himself. The 30-acre centre in Little Rock, the city where he did his politics before becoming president, will open on November 18th, and may attract 300,000 visitors in its first year. It gives Mr Clinton a plush penthouse overlooking the city. His presidential collection, the largest in the country's history, contains more than 80m documents, 2m photographs, 20m e-mails and more than 75,000 artefacts, but, alas, no Lewinskybilia.

Presidential libraries are unique to the United States. The British have the British Museum; the French La Bibliothèque Nationale. Only in America do former presidents raise millions for a presidential library under the guise of a non-profit foundation. Once it is built, the foundation turns over control to the federal National Archives and Records Administration.

This library's grand opening will have 30,000 guests, including former presidents, the just re-elected one and sundry foreign celebrities. Mr Clinton's pal Bono is expected to sing. For Little Rock, a small southern city few people knew much about until Mr Clinton's rise in fame, the week-long event is a bit like the Queen's Golden Jubilee.

In 1992, Mr Clinton changed the way politicians campaigned. He blew the saxophone on late-night television, told viewers about the sort of underwear he preferred and was late for just about everything. His library has much the same easy-going spirit.

Most presidential libraries sit in remote areas (Ronald Reagan's in Simi Valley, California) or on complicated university campuses (Lyndon Johnson's at the University of Texas in Austin, George Bush senior's at Texas A&M), which are not easy to get to. Mr Clinton, eye on the tourism dollars, has made his more accessible. He chose the patch himself in 1997—in an abandoned warehouse area close to a decent road.

The highlights include Elvis Presley memorabilia and the appeal of southern music. The library features a posh restaurant—Café 42 (Mr Clinton was the 42nd president)—overlooking the Arkansas river. Policy wonks can enjoy interactive alcoves, one entitled “Fight for Power”, which address the Clinton administration's eight years in office. A hipper-than-normal gift-store will lure political fans to a kitsch fantasia with Socks the Cat cocktail purses, Bill and Hillary cookie cutters and Clinton calendars.

After Mr Clinton's peccadillo with an intern, and his impeachment, Little Rock shied away from him. There were even protests about renaming a street after the first president from Arkansas. Some critics still claim that President Clinton did little to help his state's economy or its culture, and point out that he now lives in New York. Still, the city's leaders are hoping that Mr Clinton's star power can make this place look like a glamorous metropolis. For one week, anyway, it will.

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Washington's still unknown governor

Is Rossi close to heaven?

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The last race to be counted

IF DEMOCRATS are blue and Republicans red, Washington state is currently a sort of purple. On November 2nd its voters preferred John Kerry by a handy margin, returned another Democrat, Patty Murray, to the Senate in Washington, DC, but put Republicans into some senior jobs in the state government. Their sense of balance reached near-perfection in the fight for the governorship between Christine Gregoire, the state's outgoing Democratic attorney-general, and Dino Rossi, a Republican businessman. As *The Economist* went to press, Mr Rossi led by a mere 3,364 votes, with 85,000 ballots still to be counted.

Mr Rossi was the most electable Republican would-be governor in 20 years, because the party's right wing has previously pushed forward nutty candidates doomed to get clobbered on election day. The moderate Mr Rossi uttered hardly a peep on social issues, and was rosily simple about economic matters. Ms Gregoire, on the other hand, bent to the left to win her party's nomination. Since the outgoing Democratic governor, Gary Locke, was less than universally loved, she also tried to offer both continuity and a fresh face. No easy task.

Still, Ms Gregoire seemed the likely winner, given the state's generally Democratic sympathies and the fact that she was far better known than Mr Rossi. But she never really got to grips with Mr Rossi's relative moderation, and was slow to criticise his conservative views on abortion. She was also pretty woolly about what she herself stood for, depicting herself largely as a competent technocrat who was bound to win.

These failings may cost her the race. Although Mr Rossi's lead is razor-thin, and a recount is almost certain, the counties leaning towards Mr Rossi have more votes still to be counted than do those tilting Ms Gregoire's way. A glum Gregoire adviser called one batch of not-yet-counted ballots “10,000 votes from hell”. Or, for Mr Rossi, from heaven.

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How Anglo is America?

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More than many of you think

BACK in 1933, Winston Churchill tried to enliven a dinner party at his country house, Chartwell, with a guessing game. What is your fondest wish? Most of the guests fudged their answers, but the host had no hesitation. “I wish to be prime minister and in close and daily communication by telephone with the president of the United States. There is nothing we could not do if we were together.” Thirteen years later, he told an enraptured audience in Fulton, Missouri, that the Americans and the British “must never cease to proclaim in fearless tones the great principles of freedom and the rights of man which are the joint inheritance of the English-speaking world and which through Magna Carta, the Bill of Rights, *habeas corpus*, trial by jury and the English common law find their most famous expression in the American Declaration of Independence.”

Tony Blair's arrival in Washington this week reminds us that British prime ministers still have outsized dreams of influence when it comes to their relationship with American presidents. But what about Churchill's deeper belief—that there is something fundamentally English about America? Can we really still talk about the unique bonds of the English-speaking people in an America where multiculturalism is official doctrine and the most rapidly growing chunk of the population speaks Spanish?

The answer is surprisingly positive. The cultural affinities between Britain and the United States have been complicated since Churchill's time by everything from demography to changing intellectual fashions. Yet they remain vital to America's identity.

Start with the complications. In 1776, 80% of white Americans were of British stock (and as many were Protestants). Today only one in ten of the population claims British ancestry. Fifty years ago Anglophilia was *de rigueur* in the American establishment. Today you can still find a few people in Georgetown with Oxbridge rowing oars on their walls, but in general Anglophilia is a private vice and post-nationalism is the public virtue.

In boardrooms, globalisation is the fashionable creed. In universities, multiculturalism rules. Rather than reminiscing tweedily about dinners at Magdalen, today's humanities professors are post-structuralists who blame Britain for mass immiseration. Politicians follow suit. Bill Clinton said America needed a third great revolution (after the American Revolution and the civil-rights movement) to “prove that we literally can live without having a dominant European culture”. Al Gore interpreted the nation's motto, *E pluribus unum*, to mean “out of one, many”. George Bush likes Mr Blair and worships Churchill, but he hardly

yearns for Shakespeare as his grandfather Prescott did.

So America's Anglo-Protestant inheritance no longer enjoys the reverence it drew when Churchill mesmerised the audience at Fulton. But it is clearly more than just one culture among several. In many ways, it is still the core of the country—a point that Samuel Huntington makes with vigour and elegance in “Who Are We? The Challenges to America's National Identity” (Simon & Schuster, 2004). The definition of “Americanism” has broadened with the arrival of large numbers of non-Protestant and non-British immigrants. But Anglo-Protestant culture defines the meaning of America more than any other.

The people who settle a country first leave the biggest imprint. As Arthur Schlesinger has put it, “The language of the new nation, its laws, its institutions, its political ideas, its literature, its customs, its precepts, its prayers, primarily derived from Britain.” America's Anglo-core predisposed the country to a greater emphasis on property rights and individualism; its Protestant core predisposed it towards hard work. The melting-pot has had more and more ingredients poured into it. But the pot itself is of a recognisable Anglo-Protestant design.

It is still possible to analyse modern American life with reference to the “folkways” of the original settlers. In “Albion's Seed: Four British Folkways in America” (Oxford University Press, 1989), David Hackett Fischer divided American settlers into four main groups on the basis of where in Britain they originally came from—the Puritans, the Quakers, the Cavaliers and the Scots-Irish. James Webb claims that the Scots-Irish (who moved from the Appalachian hinterland across the South and the mid-west and now, he reckons, number about 30m) are a big part of Mr Bush's supporters. They have never shied away from using force to solve problems (Mr Webb was a tough marine in Vietnam and his book is called “Born Fighting”). They are passionately keen on religion, fiercely hostile to the state (particularly when it tries to take away their guns) and instinctively loathe self-appointed “elites”, not least of the Frenchified variety.

Multicultural, us? Spell it, please

Far from embracing multiculturalism, America is having a backlash against it. The creed may thrive in the faculties but it is rapidly waning in the rest of the country (where it arguably never waxed). Whenever Americans have been given the choice between promoting multiculturalism and protecting America's common identity, they have nearly always opted for the latter. Plenty of states—including California and Massachusetts—have passed initiatives banning bilingual education.

This does not mean that America will return to the WASPish culture that Churchill addressed at Fulton. The country's growing number of Roman Catholics dislike being told that Protestantism is the source of the country's economic dynamism. And the rapidly expanding assortment of non-Anglos hate any hint that they are less than fully American. But many scholars are beginning to recognise that America owes a great deal of its identity to its Anglo-Protestant roots. And many less cerebral folk have noted that their most stalwart allies in the war on terrorism are all drawn from Churchill's English-speaking peoples. The special relationship still has a lot of life left in it.

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Nicaragua's besieged president

In the shadow of the caudillos

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An anti-corruption drive makes Nicaragua's president popular abroad, but powerless at home, and opens the way for a ghost from the past

Get article background

BESIDES the natural disasters and civil wars typical of Central America, Nicaragua has also been cursed with a spectacularly corrupt succession of leaders. From Anastasio Somoza senior, of whom Franklin Roosevelt reputedly said that “he may be a son of bitch, but he's our son of a bitch”, to his eponymous son, who pocketed most of the foreign aid that arrived after an earthquake flattened the capital in 1972—the city centre is still largely grassland—to Arnoldo Alemán (pictured above left), who was sentenced last year to 20 years in jail for corruption and money-laundering, the country's *caudillos*, or strongmen, have contributed to making Nicaragua the poorest country in the isthmus. Its GDP per head, according to the IMF, is barely a quarter that of El Salvador, which suffered an even bloodier civil war between leftist revolutionaries and American-backed right-wing insurgents than Nicaragua did, but has done well since.

So it was to many people's surprise when the affable, comparatively old and quite un-*caudillo*-like Enrique Bolaños, Mr Alemán's vice-president, who was elected to the top job in 2001, began to tackle the country's problems head-on. With an almost cavalier disregard for the norms of Nicaraguan political life, he launched a crusade against corruption, and especially against political corruption—crowned by the jailing of his erstwhile boss.

That has won the American-educated president rave reviews abroad and substantial support from international bodies such as the IMF, as well as a handy amount of leeway for complying with their various targets for political and fiscal reform. But his support abroad is in almost inverse proportion to that at home. With about two years of his term still to run, his political base has virtually collapsed.

Local elections on November 7th gave sweeping gains to his main opponents, the National Sandinist Liberation Front, who tried to move Nicaragua to a form of socialism during the 1980s while fighting the ruinous war against the American-backed *contras*. Since voters rejected the Sandinists in 1990, they have gradually regained ground through clever tactics even as the Liberals, the supposed bastion against leftism, have weakened and split. Many fear that the main legacy of Mr Bolaños's rule could be the return

of the Sandinist leader, Daniel Ortega (on the right of the picture), to the presidency in the 2006 election.

That, especially for the current American administration, staffed with many veterans of the 1980s, would be, as one of their diplomats describes it, “dangerous”. After Cuba's Fidel Castro, Mr Ortega has long been Latin America's most potent symbol of resistance to American hegemony—so much so that when he stood in 2001, the American ambassador went on the campaign trail with Mr Bolaños. And besides many questions about his policies, the Sandinists themselves have been dogged by corruption scandals since they left office.

Mr Bolaños's difficulties began with his pursuit of Mr Alemán. Almost all the legislators from the Constitutional Liberal Party that both men belong to have stayed loyal to the outsize personality of the ex-president, leaving Mr Bolaños with just six loyal members in a congress of 92. That has stymied his reform agenda and reduced the executive to virtual impotence.

Mr Alemán's supporters in the party, such as Carlos Wilfredo Navarro, a member of the congress, argue that the jailed *caudillo* is still the “guide” and “moral leader” of the party. They resent the fact that Mr Bolaños just “used it to gain power, nothing more” and then turned on Mr Alemán. They wonder why Mr Bolaños stayed so quiet during his four years as vice-president, if corruption really was so deep and obvious.

Mr Bolaños's supporters, for their part, argue that the only reason that most of the Liberals have stayed loyal to Mr Alemán is that they all profited equally from his corruption. The president argues that “you cannot create jobs and wealth without fighting and tackling corruption”, and that his opponents on both left and right are pursuing “selfish political interests”.

What makes his situation truly desperate, however, is that the Sandinists, though notionally the opposition, are—and not for the first time—colluding with the Liberals. During Mr Alemán's presidency he and Mr Ortega made a power-sharing pact that rewrote the electoral laws to strengthen their two parties by making it harder for other, smaller ones to get into the congress; gave each of them a quota of appointments to the electoral council, the Supreme Court and the audit agency; and gave the two *caudillos* themselves, as ex-presidents, life seats in the congress, with immunity from prosecution. Mr Alemán lost his only by a whisker when the Sandinist deputies, along with nine pro-Bolaños Liberals, voted to strip him of it.

Now, in an echo of their earlier pact, legislators from both the main parties have brought their own charges of corruption against Mr Bolaños, alleging that he used several million dollars to fund his presidential campaign illegally. Though outside bodies such as the Organisation of American States have cast doubt on the way it is being done the congress may well attempt to strip Mr Bolaños of his immunity, leaving him to face trial. Since the two parties dominate the judiciary as well as the legislature, there is no doubt that they could at the very least mire Mr Bolaños's remaining two years in legal squabbles.

As the recent elections showed, the Sandinists' years of collaborationist tactics are paying off. They made gains even in Liberal strongholds such as the town of Granada in the south. They won Managua with 45% of the vote, with 13% going to APRE, an alliance party recently formed to support Mr Bolaños, and 36% to the Liberals. But APRE polled an average of just 9% nationwide. At a fight between supporters of Mr Bolaños and of Mr Alemán at a polling station, a journalist was shot dead. Unless the Liberals, divided and tainted by Mr Alemán's shenanigans, can find a credible alternative candidate, nobody stands in the way of Mr Ortega's ambitions of a return to power.

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A Mexican shopping scandal

Pyramid schemes

Nov 11th 2004 | TEOTIHUACÁN
From The Economist print edition

The free market meets the sun-god

EPA

Symbols of Mexican nationhood

AT THE end of last week, Bodega Aurrerá, a Mexican subsidiary of the world's biggest retailer, Wal-Mart, opened a new store in the village of San Juan Teotihuacán, just north of Mexico City. Normally, such an event would cause little stir. Wal-Mart is already Mexico's biggest retailer too. And its shops seem to go down very well with its millions of bargain-hungry customers. But this particular opening was, in fact, the culmination of months of protests, legal actions, hunger strikes and hyperbole by those determined to stop it.

The reason is the location. Just 2.5km (1.6 miles) away is the ancient city of Teotihuacán, probably Mexico's most famous archaeological site. Amongst other attractions, it boasts the third-largest (by volume) pyramid in the world. For many Mexicans, the ancient site, abandoned by its mysterious inhabitants centuries before the Spanish conquerors arrived, remains the ultimate symbol of Mexican identity and nationhood. Thousands troop up to the top of the Pyramid of the Sun to celebrate the summer solstice.

To them, the idea of having a Wal-Mart next door is abhorrent. In the words of Homero Aridjis, a writer and one of the leading opponents, “it is like driving the stake of globalisation into the heart of old Mexico.” The controversy is only the latest in a string of protesters' attempts to save Mexican culture from what they see as a creeping menace. They won a famous victory by blocking a McDonalds restaurant from opening in the main square of the pretty southern colonial town of Oaxaca.

But this time they were on much thinner ground. For a start, Wal-Mart went through all the appropriate regulatory hoops, even getting permission from the Paris-based International Council on Monuments and Sites, which judged that the store would cause no harm to the nearby ruins. A small stone platform was indeed found during construction of the new car park, but was preserved.

Just as importantly, the claim that the new store spoils the famous view from the top of the Pyramid of the Sun is clearly bogus, as anyone who cares to get to the top can testify. The problem is not so much that you can see the Wal-Mart, but one of trying to distinguish it from the 30-odd other ugly, squat buildings that litter the surrounding countryside—to say nothing of the car parks, the electricity pylons and the large power station. Sadly, unrestricted building long ago ruined this particular view, as well as many others in Mexico.

To the diehards, the issue counts more than the view. But neither mattered much to the hundreds of locals who queued up for the opening, delighted to be freed of the small and expensive local shops. Despite a legal case pending against Wal-Mart and local officials, brought by an irate local left-wing politician, this is one battle that the American retailer has probably won.

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Ecuadorean politics

Indian influence

Nov 11th 2004 | QUITO
From The Economist print edition

The indigenous party is still an important political force

Reuters

Get article background

Preparing for power

THOUGH Latin America's millions of indigenous peoples have many campaigning groups, they have few political parties. And none has had the influence or the roller-coaster ride of Ecuador's Pachakutik. From rabble-rouser to government coalition member to feisty opposition in four years, it helped overthrow Jamil Mahuad, Ecuador's president, in 2000, and elect Lucio Gutiérrez to the post in 2002. Party leaders feared that it might have alienated supporters when it left Mr Gutiérrez's coalition, in which it had little say, in 2003. And so it seemed, when protest marches called earlier this year fizzled after a few days, instead of driving out the president as promised.

So the party was relieved when local elections last month gave it—thanks partly to other party alliances—about the same number of mayors and provincial prefects as in its earlier heyday, mostly in the highlands and the Amazonian region where the country's estimated 4.8m Indians tend to live. Its leaders say it is respected for sticking to its guns when Mr Gutiérrez turned from a populist left-winger into a disciple of macroeconomic orthodoxy.

And its momentum against the president is reviving. Besides helping block some of his bills in Congress, it is a member of a coalition that tried to impeach him for allegedly using state property and funds to support his own party, which nonetheless performed disappointingly in the elections. This week the coalition tried to create a congressional “very special commission” for impeachment, though it gave up after six legislators failed to show up for the vote.

Still, even Pachakutik's leaders have admitted that simply opposing the president is not much of a political platform. The group's challenges include changing from an “Indian party” to a multicultural one and including other disenfranchised racial groups, such as blacks. While several Ecuadoreans who classify themselves as mixed-race *mestizos* hold important positions in the party, most of its support base remains indigenous.

Pachakutik will have to make inroads in larger cities and coastal areas if it is to become more than a regional party. It has to iron out differences with the CONAIE, the national indigenous body from which it sprang. It suffers from breaches between Amazon and highland Indians, Catholics and Protestants, and the remaining supporters of Mr Gutiérrez and his detractors. Some Pachakutik and CONAIE members have been criticised for wearing “golden ponchos”—ie, succumbing to elitism.

Despite Pachakutik's political savvy, Indians continue to be among the poorest in a poor country. They rank lower than the national average on education and most other indicators of wellbeing. And although they have won legal protection in the constitution and in international agreements, it is not always fulfilled.

The party's greatest successes continue to be more local. For example, the Indian mayor of the highland town of Cotacachi, Auki Tituaña, has earned international praise for innovative health and welfare programmes. Pachakutik recently helped push approval through Congress for an “intercultural university”, which will include traditional as well as modern teachings. Whether such efforts spread could

be a better pointer to Pachakutik's future than any election or impeachment.

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Gay marriage in Canada

Bound by law

Nov 11th 2004 | OTTAWA
From The Economist print edition

Canada moves towards fully legalising same-sex marriage

Get article background

FOUR days after the people of 11 American states, including Montana and North Dakota, voted (alongside their presidential ballot) in favour of banning gay marriage in the constitution, just across the Canadian border two women, Erin Scriven and Lisa Stumborg, said their vows in a church in Saskatoon, in the province of Saskatchewan. Just the previous day a family court judge, Donna Wilson, had issued a decision legalising same-sex marriages in the province.

Her ruling was part of an accelerating trend. Since an Ontario court ruled same-sex marriages legal in June 2003, courts in five other provinces and in the Yukon territory have followed suit, three of them in the last two months. There are more to come. Last week in Newfoundland and Labrador province, two couples began court action under the equality clause in the federal constitution's Charter of Rights and Freedoms. Governments in New Brunswick and Prince Edward Island have so far stood back and argued that it is not their affair because the capacity to marry (though not the ceremony itself) falls under federal jurisdiction. Other provincial governments have not opposed the court actions, for the same reason.

Only Alberta, the most socially conservative province, has fought the trend. In March 2000 the legislature amended the provincial marriage act to define marriage as exclusively between a man and a woman, and added a clause insulating this law from a charter challenge. When Canada's previous prime minister, Jean Chrétien, published a draft law in July 2003 to legalise same-sex marriages, a Calgary bishop threatened him with purgatory. The Alberta premier, Ralph Klein, has said that he will use the federal constitution's "notwithstanding" clause, which gives provinces some freedom to pass laws that go against the charter, to stop a federal gay-marriage law from applying in his province. The federal Conservative leader, Stephen Harper, who represents Alberta in parliament, has said he would use that clause himself—perhaps to give Alberta a breathing space—if his party wins the next federal election.

It is a headache for Paul Martin, the current prime minister. Back in 1999 he voted for a bill modernising marital benefits and obligations that used the traditional definition of marriage. But in September 2003, when the Canadian Alliance (the predecessor of the Conservatives) proposed a resolution to reinforce that definition and apply it in all future federal laws, Mr Martin—then still a backbencher—voted against. Not all of his Liberal colleagues, however, felt liberal enough to join him, and the measure was blocked by just five votes. If a gay-marriage law were introduced now, with the Liberals not only split on the issue but also a minority in parliament since June's election, Mr Harper would hope to defeat it.

Which is why the Liberals have decided both to delay the question and to fob it off on to someone else: the Supreme Court. Mr Chrétien's government asked the judges to rule on whether the draft gay-marriage law was constitutional under the federal charter, and whether individual church ministers could still decide not to perform same-sex marriages. Mr Martin, delaying further, added another question, about an opposite-sex requirement in Quebec's marriage law. Then he filled vacancies on the Supreme Court with two women judges with progressive views.

The court held hearings last month, and faced a long queue of protesting groups. A lawyer for the Seventh Day Adventist church argued that legalising same-sex marriage would only encourage pleas for polygamy. One for the Catholic bishops suggested that the state's interest in marriage should be procreation.

Beverley McLachlin, the chief justice, rebuked the federal government for referring the matter straight to

the Supreme Court, which normally rules only on appeals against lower court verdicts. In effect, she was complaining, the court is being asked to do the government's political dirty work. Mr Martin will use the judges' expected positive answers, due early next year, to push through a free vote on the same-sex marriage bill. But no sooner has he legalised gay marriage than he will have to do the same for gay divorce: one lesbian couple in Ontario has already won the right to dissolve their partnership.

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About sponsorship

Japan

The incredible shrinking country

Nov 11th 2004 | TOKYO
From The Economist print edition

Magnum

Japan's population will soon start getting smaller as well as older

Get article background

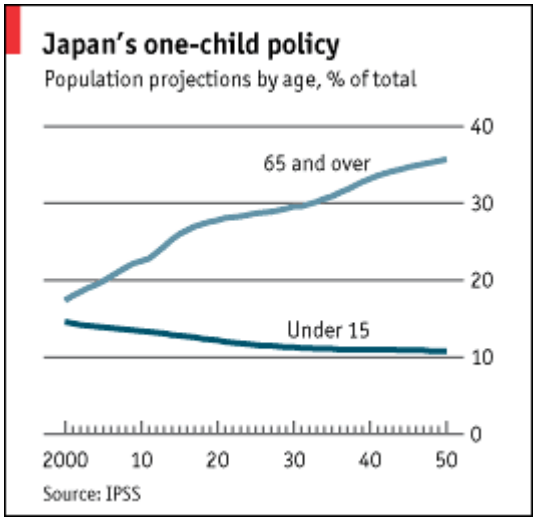
OZAKI SHOJI, one of Japan's biggest makers of school uniforms, has a problem. Its core product is in increasingly scarce demand, as the number of Japanese children drops. So Ozaki Shoji has branched out into casual wear, in the hope of widening its target age-group. A small rival, Onoto, which like Ozaki Shoji is based in the south-western prefecture of Okayama, seems to be having a harder time adapting. Its managers think that a trend towards more individualism in schools is also reducing demand for uniforms, in addition to the demographic trends that are hurting their firm.

The problem is not confined to uniform-makers. Low birth rates mean not only fewer schoolchildren in Okayama, but also fewer young workers for Onoto's factories. This is just the start of a demographic shift that will trigger profound changes in Japan's economy and society.

The projections vary, but most experts believe that Japan's population, now 127.6m and barely growing, will peak some time between next year and 2007, and then begin a long, steady slide that will last several decades at least. Japan's Institute of Population and Social Security Research (IPSS) forecasts that the population will fall to somewhere between 92m and 108m by mid-century, with a medium-case prediction of about 100m people in 2050. The United Nations foresees a slightly smaller drop over the period, but still to around 105m people.

Even though Japanese lifespans continue to lengthen, the country simply will not have enough young people to maintain its population. The fertility rate (the number of children per woman during her lifetime) fell below 1.3 last year, down from 3.65 in 1950. Although Japan's bureaucrats have launched a drive to promote childbirth—including tax breaks and rules helping parents take more leave—the fertility rate is expected to stay low for at least a few decades. By 2050 the proportion of children under 15 will fall to less than 11% of the population (see chart), from 16% in 1995. The average Japanese will then be over 53 years old, 12 years older than now.

This will affect everything from work and family life to foreign policy and national security. Japan will probably have to let more workers immigrate, though public unease will no doubt lead it to delay and minimise this shift as much as possible. A smaller population may also mean slower economic growth; that will take its toll on spending categories, like defence, whose clout depends more on total economic weight than on income per person.



One obvious consequence will be pressure on the social-insurance system, including health care and pensions, as the working-age population shrinks dramatically. The IPSS reckons that there will be 31m fewer Japanese between 15 and 64 years old in 2050, and that this group will shrink from two-thirds of the population now to just over half. The ruling Liberal Democratic Party lost ground in the elections for the upper house this summer, partly by forcing through benefit cuts and higher premiums on pensions. But more will have to follow. The speed of this demographic shift and Japan's high debt levels (the IMF says Japan's net public debt is around 80% of GDP) have led some to worry about a looming fiscal implosion.

A pair of economists in America—Christian Broda of the New York Federal Reserve and David Weinstein of Columbia University—have recently created a stir by arguing that these worries are overblown*. Most of the debate has concentrated on their long-term arithmetic: they think that Japan's population is bound to stabilise at some point, perhaps around 2060, and that Japan will therefore be able to ease the demographic transition by spreading the costs over the course of a century or more. As in other countries, the Japanese have chosen careers over children as they have grown richer. The authors argue that at some level of prosperity, however, they will value extra money less and will want bigger families.

Messrs Broda and Weinstein also make another point, however, that deserves more attention. They argue that fewer children will, in a variety of ways, save Japan some money. "If an ageing population means an increase in government transfers to the elderly," they write, "then by the same logic, a drop in fertility rates should mean a decrease in expenditures on younger Japanese."

There will certainly be fewer pupils, and therefore less demand for schools and teachers. Eventually, this will affect universities as well, which are already reorganising to brace themselves for greater competition. A tighter labour market will also reduce the need for unemployment insurance and other fiscal transfers to the young. Japan's unemployment rate remains high, at 4.7%, despite a recent recovery, and the jobless rate among the youngest workers is more than twice that. Within a few years, however, the labour market, especially for young people, should tighten dramatically.

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* "Happy news from the dismal science: reassessing Japan's fiscal policy and sustainability"

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China

The emperor is not always obeyed

Nov 11th 2004 | BEIJING
From The Economist print edition

It's not easy to slow down the economy

Get article background

IT WAS a scathing, and very public, scolding that the local authorities in eastern China's Jiangsu province earned for themselves when earlier this year they were caught trying to sneak a huge new steel plant past the central government's regulators, who had ordered a slowdown in the steel industry. China's Communist Party mouthpiece, the *People's Daily*, berated local officials for going beyond their powers and conniving with the Jiangsu Tieben company illegally to push forward the $1.3 billion project. This, sniffed the *People's Daily*, marked a “serious violation of the state's laws and decrees”.

In its details, the Tieben case highlights many of the new contradictions created by China's continuing transition from central planning and state ownership to something nearer market economics. Upstart private firms like Tieben now play an important role in bringing a new vitality to China's industries. But some essential things—such as bank credit and political support—still flow much more readily to state-run enterprises, and China has a long way to go in making the competition a bit fairer for those in the private sector.

More broadly, the Tieben case exemplifies the tensions that go back as far as 2,200 years, to the very roots of China's imperial bureaucracy. Even the strongest of China's ancient emperors found it hard to control far-flung local officials, and it is a cat-and-mouse game that today's Communist mandarins continue to play.

Over the past year, the central government has sought to limit economic overheating with a mix of macroeconomic and administrative measures. Last month's interest-rate increase, China's first in nine years, was preceded by a series of orders curbing bank lending and restricting fixed-asset investments, especially in such booming industries as cars, property, aluminium and steel. At the local and provincial levels, however, officials have understandably remained keen to keep up growth rates, tax revenues and employment figures in their own bailiwicks. They have seen the imposition of any measures designed to slow economic activity rather as they might look at a toxic-waste dump: vital for the greater good, to be sure, but better in someone else's backyard.

In the old days, the centre controlled everyone's purse-strings, and it fell to the powerful State Planning Commission (SPC) to decide what got built and where. But in its march towards a market economy China has turned more decision-making power over to the provinces, and it has converted the SPC into the cheeringly less dictatorial National Development and Reform Commission (NDRC).

According to Wang Yiming, vice-president of the NDRC's Academy of Macroeconomic Research, the centre has gone from issuing orders to merely “trying to convince local governments that the centre's policies are in their own best interests”. That task, he added, has been complicated by the rising influence of private firms. Previously limited to the labour-intensive manufacture of light-industrial goods such as toys, pens or shoes, private enterprises can now muster the wherewithal to invest in capital-intensive projects such as car factories and steel plants.

Victor Shih, who watches China from Northwestern University in the United States, says that the central government faces a continuing struggle to control the flow of money and investment. It remains fairly effective in regulating bank lending, thinks Mr Shih, “but there are huge sums of private money sloshing around that Beijing cannot control.” Despite having largely surrendered control of both purse-strings and economic decision-making, the centre has kept a firm grip on the hiring and firing of officials throughout the bureaucracy, and this is its best defence against rebellious local governments.

“In the end, it is very simple,” says Mr Wang of the NDRC. “Local officials know that if they disobey orders from the centre they can be dismissed.” Unfortunately for the centre, however, the mice out there far outnumber the indignant cats of Beijing.

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China and Central Asia

Fear of the dragon

Nov 11th 2004 | ALMATY
From The Economist print edition

China still spooks its neighbours

ON THE surface, relations between China and its Central Asian neighbours have never been better. September saw the start of the construction of a 1,000km (620-mile) pipeline that will take oil across eastern Kazakhstan into China's western Xinjiang region, and could eventually run all the way from the Caspian to the whole of energy-hungry China. The governments of Kirgizstan and Tajikistan are keen to strengthen their links with booming China. In May Tajikistan and China opened a new border crossing.

But the success of Central Asia's leaders in getting closer to China is viewed with considerable suspicion by their own people. Although there is no concrete reason to suspect China of bad intentions towards Central Asia since the region broke away from the Soviet Union in 1991, ancient fears of Chinese expansionism still persist. Sinophobia is common—even among politicians, when speaking off the record.

The fears are strengthened by the growing number of Chinese in Central Asia. Officially, Kazakhstan has only 1,200-5,000 and Kirgizstan not many more than 5,000. Unofficially, estimates run to 300,000 Chinese in Kazakhstan alone, most of them traders. Even Uzbekistan, which has no border with China, admits to worrying about illegal immigrants from China. Some 1.3 billion people are crowded into China, whereas the whole of ex-Soviet Central Asia has only 60m.

The worries about what China might one day do are partly based on Soviet-era propaganda. It used to be drummed into all Central Asians that China was the prime enemy, because it claimed 1.5m square kilometres of Soviet territory, much of it belonging to the republics of Kazakhstan, Kirgizstan and Tajikistan. The fear was reinforced in 1969, when Soviet and Chinese troops clashed along the border of Kazakhstan and China's Xinjiang province. That was only 21 years after China's Communists had got their hands on Xinjiang, and 19 years after China had marched into Tibet.

Although the governments of the three republics have managed to negotiate full border agreements with China since their independence—something the Soviet Union failed to do during its 69 years of existence—local people say they are convinced that the last word has not yet been spoken. Konstantin Syroezhkin, a China pundit in Kazakhstan's former capital, Almaty, says that, although the question of the common border may have been solved, other problems are still a worry. The decision to shift the capital to Astana in 1997 was taken partly in order to move it further away from the Chinese border.

Both Kazakhstan and Kirgizstan are now nervously watching the flood of ethnic Chinese moving to Xinjiang, and the economic boom in that part of China. New rail links and good roads are seen by some Central Asians as a potential springboard for China's expansion even further west, into Kazakhstan's vast and largely empty territory, maybe 20-30 years from now. All paranoid nonsense, of course.

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Job-preferment in India

A backward cast of mind?

Nov 11th 2004 | DELHI
From The Economist print edition

Business faces demands for positive discrimination in its hiring policies

ONE of the reforms that economists and businessmen would most like to see in India is a relaxation of its restrictive labour laws. These are seen as counter-productive: by making it hard to fire workers, they discourage investment and job-creation, two central aims of the government that took office in May, led by the Congress party. Yet instead of moving to liberalise these laws, the government has been talking of yet another restraint on the freedom to hire and fire.

It has been contemplating the introduction of “affirmative action”, meaning mainly quotas, to secure jobs for the poorer half of India's population. This includes various tribal groups, as well as *dalits*—once known as “untouchables”, born at the bottom of the Hindu caste system—and “other backward castes”.

Positive discrimination, including “reservations” covering public-sector jobs and places in schools and colleges, was envisaged in independent India's constitution in 1950—and soon formalised into 15% quotas for *dalits* and 7.5% for “scheduled tribes”. Attempts to extend this to cover the further 25% or so of the population deemed “other backward castes” ran into furious opposition in the early 1990s. And, until recently, private businesses were regarded as exempt. Now, though, in the “common minimum programme” of Congress and its coalition partners, the new government professes itself “very sensitive to the issue of affirmative action, including reservations, in the private sector”. It has set up a group of ministers to open a “dialogue” on the issue.

Rajiv Desai, the head of IPAN, a consulting firm, says that, in a conversation with him, the prime minister, Manmohan Singh, had argued that something must be done. Because of the increased role of private business in the Indian economy, the country's leaders must, on this issue, “come to terms with the realities of India”.

Business, however, strongly opposes compulsory quotas. The government of Maharashtra, India's richest state, has already drafted legislation that would “reserve” more than half the jobs in some companies for tribes, *dalits* and “other backward castes”. Many people saw this as part of the campaign for the state elections held last month. But some businesses have threatened to leave the state if it is ever implemented.

Many analysts agree that, in the public sector, the practice of reserving jobs has been widely abused: some local officials have even sold fraudulent caste certificates. But the issue has become a vote-winner, especially in states, such as Bihar and Uttar Pradesh, where some “other backward castes” like the Yadavs form a large minority. Lower-caste politicians have become national power-brokers by astute appeals to caste loyalty.

It is far easier for them to undertake to defend and extend reservations than to think of ways of making real economic progress. So parties in different states are constantly hunting for votes by proposing new reservations—for Muslims, say, or for sub-categories of *dalits*(a proposal blocked by the Supreme Court as unconstitutional only last week), or even for the poorer sort of upper-caste families.

Labour legislation in India can apply only to what is called the “organised sector”—which means firms employing more than ten people. Of a national workforce of over 400m, only about 9m are in the private organised sector. For this reason, Chandrabhan Prasad, a *dalit* writer, supports quotas but argues that more important is help for *dalit* businesses in the “unorganised” sector, where distributorships, grants of alcohol licences, construction contracts and so on are involved.

Amit Mitra, of the Federation of Indian Chambers of Commerce and Industry, supports similar schemes,

as well as preferment schemes by banks. He sees the root of the problem in the high-school dropout rate among *dalits* and tribals, but backs a voluntary system in which the government would offer tax or other incentives to firms that meet employment targets. The question of private-sector quotas is not going away. IPAN's Mr Desai says that they would be unworkable, but that some managers are beginning to see job-preferment as good for business. The government's hope must be that this view gains currency, before another business-deterring law hits the statute books.

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Indonesia's parliament

A gleam of light

Nov 11th 2004 | JAKARTA
From The Economist print edition

At last, a real opposition

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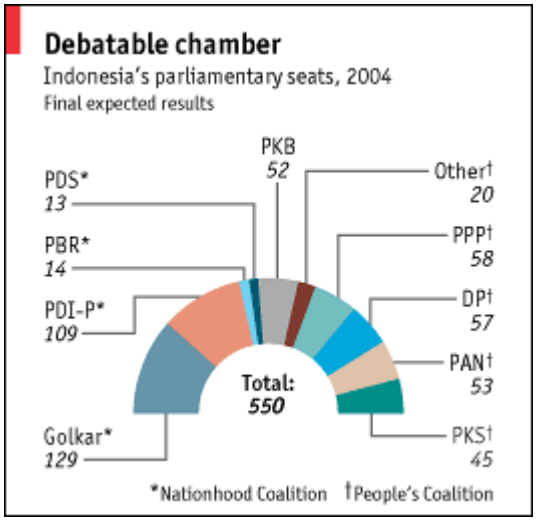

INDONESIA'S latest parliament set to work last month and chose a new speaker with only an average amount of fuss. Since then, however, it has collapsed into virtual paralysis. The 550 legislators, about 70% of whom are new, have not even been able to decide who should lead its 11 commissions and five other influential bodies, such as the internal budget panel—let alone start coping with the backlog of legislation awaiting their attention.

The supporters of President Susilo Bambang Yudhoyono are to blame. Comprising five of the ten parliamentary factions, and calling themselves the People's Coalition, they have exploited the rules in order to block things. Though they will control only 233 seats, that will be enough to stymie parliament's business. According to the rules, a plenary session of parliament (needed to elect chairmen) requires the attendance of both two-thirds of all members and a majority of the factions.

The coalition is in blocking mood for two reasons. First, it is angry over a bid by the larger and much more cohesive group of factions—the Nationhood Coalition—to hijack the selection of commission leaders by insisting on their being elected rather than, as standing orders state, divided proportionally according to the distribution of seats. Second, it wants to block the Nationhood Coalition from summoning President Yudhoyono to explain himself over the choice of a new head of the armed forces. Mr Yudhoyono has angered them by cancelling his predecessor's last-minute nomination of General Ryamizard Ryacudu for that job.

Attempts to resolve the crisis appear to be bearing fruit, though it is a slow process and the legislature is unlikely to become fully functional for at least several more weeks. Even so, the row has revealed several things that may bode well both for Indonesian democracy and for Mr Yudhoyono's presidency.

For the first time in five decades there is a powerful opposition in parliament, outside the tent of power and patronage. When the Nationhood Coalition's candidate for the presidency, Megawati Sukarnoputri, lost her job, its leaders were largely excluded from the cabinet. So its members may at last start to see it as their role to be a check on the abuse of executive authority. They will not, however, be able to do this too cavalierly, since recent constitutional amendments mean that they cannot use their majority to impeach Mr Yudhoyono on a whim.

One consequence is that decision-making has already become more open. On the way out are the days when parliament either rubber-stamped presidential orders or took decisions at secretive meetings in smoke-filled suites at five-star hotels. Mr Yudhoyono has further reason to cheer. Seeking to flex their parliamentary muscles, Golkar and Miss Megawati's Indonesian Democratic Party of Struggle, the two largest parties in the Nationhood Coalition, have discovered they are not as strong as they had hoped.

This is only the first of what will be many skirmishes between the parliamentary coalitions, and between parliament and president. It will be messy. But if the right lessons are learned by all involved, there is less reason to despair than Indonesia's censorious editorial writers would have the nation, and the world, believe.

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Tahiti

South Sea bubble

Nov 11th 2004 | CHRISTCHURCH
From The Economist print edition

Whose turn to be president?

TAHITI today is not the calm South Seas paradise depicted in Paul Gauguin's paintings of languid Polynesian women. Two rival governments are claiming the right to hold office in the French “overseas territory”, each accusing the other of being a usurper. One side is led by Oscar Temaru, who favours independence and was ousted after a vote on October 9th but refuses to get out of the presidential premises. His supporters have set up camp in protest in the gardens outside.

His replacement, Gaston Flosse, is a long-time ally of France's president, Jacques Chirac. He has cut the telephone lines to the presidency and has started running French Polynesia's affairs from nearby government buildings. Both sides have delegations mobilising support for the consequent legal and political battles in Paris.

It all began in May, when Mr Temaru's coalition, the Union for Democracy, unexpectedly emerged victorious at the polls, dislodging Mr Flosse from his long incumbency and setting off alarm bells in Paris. But the new Polynesian-led government obtained only a one-seat majority in the 57-member assembly. Five months on, a single defection enabled Mr Flosse first to engineer a 29–0 censure vote against the government and then, by the same margin, to restore himself as president.

Mr Temaru's supporters, who boycotted both votes, are outraged. Demanding the dissolution of the assembly followed by fresh elections, they have organised a 15,000-20,000-strong demonstration through the streets of the capital, Papeete. This week, protesters blockaded government buildings and organised a 24-hour general strike.

Legally, Mr Temaru's case may seem weak. Politically, it looks much stronger. Mr Flosse has allies in high places, but the tale of Mr Temaru's abbreviated government has captured popular support, both in France and in Polynesia. The election in May was a verdict on Mr Flosse's previous administration, not a vote for independence. Many who want to keep the links with France still support the Temaru government's right to complete its term in office. If, instead, Mr Flosse's government is allowed to limp on with its one-seat majority, that may push more Polynesians into the pro-independence camp.

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Iraq

The battle for Fallujah now—and for hearts and minds later

Nov 11th 2004 | BAGHDAD
From The Economist print edition

EPA

Will the political cost of smashing the rebel stronghold of Fallujah be worthwhile?

Get article background

AFTER months of trying to dodge the homemade bombs and mortar rounds of an often invisible enemy, on November 8th an American armed force began the kind of operation it likes best. Following a fierce air and artillery bombardment, infantry and tanks, aided by a larger-than-expected contingent of pro-government Iraqi troops, began moving into the rebel-held town of Fallujah. Three days later, they said they controlled three-quarters of the city, including the district of Jolan, a labyrinth of alleys that has been the rebels' stronghold.

The Americans, with up to 15,000 of their own and allied Iraqi troops involved in the attack, said that resistance was lighter than expected, but their own death toll—11 soldiers, along with two Iraqis—was already higher than their losses in April, when they abortively assaulted Fallujah for several weeks.

The American aim is to rid the town of the 3,000-plus fighters, many of them said to be foreign fundamentalist fanatics, without rallying insurgents against the Americans across the country and making it even harder to hold the general election due by the end of January. Plainly, limiting the number of civilian casualties is crucial to fulfilling that aim. First reports suggested that a large majority of the town's 300,000-odd inhabitants had fled to Baghdad, 50km (32 miles) to the east, or to makeshift refugee camps nearby.

Still, the Americans made full use of their firepower to move into Fallujah as fast as possible so as to avoid the steady build-up of Iraqi outrage during April's fighting. They managed to capture, early on, the town's main hospital—the source of damaging reports, last time round, that hundreds of civilians had been killed.

But the political risk remains high. In April, Sunni Arabs with tribal and religious ties rallied across western and central Iraq in support of the town, running guns through an American blockade and ambushing supply columns. After the siege was over, the rate of rebel attacks shot up nationwide, especially in towns along the Euphrates river with tribal links to Fallujah.

Some Iraqi politicians predict a similar new wave of violence. Before the interim prime minister, Iyad Allawi, declared a state of emergency on the eve of the offensive, insurgents had hit Iraqi security forces hard. Car bombings, mortar strikes, police-station assaults and other attacks since November 6th killed more than 120 Iraqis in Samarra, Baqouba, Latifiya and other Sunni Arab towns across the centre of the country, while insurgents vowed to go on shooting the Americans and their allies so long as the Fallujah battle lasts.

There may not be that many would-be fighters left to mobilise among those tribes and religious groups who have a sense of kinship with the Fallujah defenders. The Jordanian arch-terrorist, Abu Musab al-Zarqawi, said to be responsible for many of the most gruesome acts of violence in Fallujah and elsewhere, may have fled the city before the big American assault. And the city itself may be worn out by seven months of siege and bombing, as well as by the presence of volatile Islamist radicals who execute anyone they suspect of spying. Some of Fallujah's refugees now in Baghdad say that, much as they detest the American occupation, they just want the whole ordeal to be over.

The attack has prompted many Sunni Arabs to rush to distance themselves from Mr Allawi. The Muslim Scholars' Board, an influential gathering of Sunni clergy who broadly back the insurgents, has told Iraqis to boycott January's election, which it said would be held “over the remains of the dead and the blood of the wounded in Iraq's cities”. The Iraqi Islamic Party, Mr Allawi's main Sunni Arab partner, said it would leave the government. But the board would probably have urged a boycott anyway, while the Islamic Party's lone minister in the cabinet has apparently yet to leave his office. Those Sunni Arab groups who had already decided to compete for power at the polls will probably still try to do so, particularly if the worst of the fighting ends fast.

In any event, suppressing the insurgents in Fallujah will not make Iraq stable. It may deprive the militants of their biggest safe haven, but many more towns in the Euphrates valley are plainly out of the central government's control and may also shelter the fighters. Moreover, a recent wave of attacks shows that the guerrillas do not need a geographical base to wreak havoc. The Americans have hoped in vain that, once the insurgent grip is weakened in any town, the Iraqi police would over time build up the networks of informants they need to nip rebel activity in the bud.

This has not happened, for instance, in Samarra, the first big Sunni town to be retaken from insurgents. A joint American-Iraqi force stormed it last month, but since then the two wings of its garrison have feuded, with hometown policemen accusing a National Guard detachment of antagonising the populace with clumsy raids and the guardsmen accusing the police of being bought off by insurgents and gangsters. Neither lot exercises much authority, and neither stopped a series of car bombs that tore through the town on November 6th, killing 35 people. The worst outcome for the Americans is that Samarra exemplifies the Sunni Arab heartland: a town nominally under Baghdad's control but in practice ungovernable.

An American victory in Fallujah would at least be symbolic. In the summer, when one town after another fell to the rebels, it looked as if they might slowly take over the country; now they may be losing ground. Mr Allawi makes it plain that any faction wanting a share in a future government must make its peace with the system.

One leader who has recently come into the fold is the Shia preacher, Muqtada al-Sadr. Just before the attack on Fallujah, his followers quietly announced they had joined a pan-Shia electoral alliance sponsored by Iraq's foremost cleric, Grand Ayatollah Ali al-Sistani. Mr Sadr is staying a bit aloof: he says he will not be a candidate for election, nor will his main clerical aides. But he sounds loth to boycott the election or dispute its legitimacy. Provided the fighting in Fallujah does not spin out of control, that should go a long way towards ensuring that Iraq's Shia south will not be engulfed by a wider insurgency.

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Palestine and Israel

After one old man has gone

Nov 11th 2004 | JERUSALEM AND RAMALLAH
From The Economist print edition

Hope for fresh diplomacy and the struggle for succession go hand in hand

Getty

The long goodbye

Get article background

THE first aim of the Palestinians' diverse leadership, in the wake of Yasser Arafat's death in France on November 11th, is to project a sense of unity as it steps gingerly into a new era. Mr Arafat's body—it was decided even before his death—would, after a state funeral in Cairo, be buried in the compound of his headquarters in Ramallah, on the West Bank, where their fledgling Palestinian state has its headquarters. In the immediate aftermath of his slow death, Palestinians, high and low, appeared united in grief for their iconic leader of the past four decades (see our obituary).

Not, perhaps, for long. The bigger question is whether the new leaders will have the power and skill to steer through the rapids awaiting them in the next few weeks and months. Almost certainly the two helmsmen will be Mahmoud Abbas (also known as Abu Mazen), general secretary of the Palestine Liberation Organisation (PLO), which represents Palestinians everywhere, and Ahmed Qurei (Abu Alaa), prime minister of the Palestinian Authority (PA), the territorial government. In the Palestinian hierarchy, the PLO is the higher body; so Mr Abbas, quickly elected its new chairman, is Mr Qurei's boss.

The two men's policies are pretty similar. Both advocate reform and a separation of powers between the PLO and the PA; both oppose the violence of the Palestinians' current four-year uprising, especially against Israeli civilians; and both want a return to negotiations with Israel along the lines of the international “road map”. But both are politically weak, not least within their own—and Mr Arafat's—Fatah movement, long the dominant force in the PLO.

Mr Abbas was once backed by Fatah's younger generation of leaders, including its best-known tribunes: Marwan Barghouti, Fatah's leader on the West Bank, now serving five life sentences for complicity in killing Israelis, and Mohammed Dahlan, once the PA's minister for security.

From his prison cell Mr Barghouti supported Mr Abbas's brief premiership last year but became disenchanted by its failure to cut any ice with Israel's prime minister, Ariel Sharon, or with President George Bush, let alone Mr Arafat. In July, Mr Dahlan told his armed backers to take to Gaza's streets in violent protest against Mr Arafat's refusal to reform the PA's police.

But Messrs Abbas and Qurei will be even more hampered by the old guard in Fatah, especially those who returned with them and Mr Arafat from exile in Tunisia to Palestine a decade ago, and whose power derived solely from the old man's patronage. It rightly sees Mr Arafat's demise as a prelude to its own; it fears that the reforms Mr Abbas and Mr Qurei want to promote would spell its doom.

Signs of this coming power struggle were evident this week in meetings in Mr Arafat's headquarters in Ramallah, even as the world awaited his death. The reformers, including Fatah people allied to Mr Barghouti, the most popular Palestinian leader after Mr Arafat, insisted that any transition be done by the law. This says that the PA's presidency, held by Mr Arafat, must pass to the Palestinian parliament's speaker until a new president is directly elected—within 60 days.

Aware that it might lose its seats, the old guard has opposed direct elections, insisting that parliament alone should choose a president. Mr Abbas is reported to have wobbled, suggesting that an election be deferred for six months, with parliament picking an interim president. The reformers won this early round: Rauhi Fattouh, the speaker, who has no clout of his own, has already been made acting president. But the reformers were disappointed by the dithering of Messrs Abbas and Qurei.

In this, as in much else, the reformers have Palestinian public opinion on their side. Polls show solid majorities not only for a presidential election but also for local and parliamentary ones. They are supported, too, by the Islamists of Hamas and Islamic Jihad, both of which have called for new elections and for a united front, embracing both Islamists and secular parties, to prepare for them. They have also implicitly warned Mr Abbas and Mr Qurei not to take any steps to stop the “armed *intifada*”, as the uprising is known.

Some Palestinians are looking for help from abroad. Egypt's president, Hosni Mubarak, says he is seeking American help to convert Mr Sharon's unilateral plan to leave the Gaza strip into a bilateral negotiation with a new Palestinian leadership. The starting point would be a ceasefire between the Palestinians and Israelis.

Foreign helpers

Egypt is convinced it has persuaded Fatah and Hamas, as well as Messrs Abbas and Qurei, to agree to a truce. Mr Sharon has always rejected one, on the ground that the Palestinian militias' disarmament must precede any negotiation. Mr Abbas lacked the power to do this when he was prime minister. He and Mr Qurei have less power now. So there is no certainty that a truce can be made to hold.

In any event, Mr Arafat's demise has created rare accord among Israeli politicians. Both Yossi Beilin, who runs a small peace-seeking party on the left, and Binyamin Netanyahu, the finance minister who wants to lead the ruling Likud party from the right, have been telling Mr Sharon to reconsider his Gaza withdrawal: with Mr Arafat gone, Israel should try to seek an agreement with a new Palestinian partner. And some of Israel's generals and diplomats are urging Mr Sharon to bolster Mr Arafat's reform-minded heirs by offering gestures such as the release of prisoners.

Mr Sharon, though acknowledging a possible “historic turning-point”, balks at such ideas: “We don't yet have a partner.” He still says he will negotiate with a new Palestinian leadership only after it curbs terror. Meanwhile, he would rather wait and see how events among the Palestinians unfold.

Besides, Mr Sharon's troubles at home are far from over. The right-wing National Religious Party, which fiercely opposes the Gaza withdrawal, deserted the ruling coalition this week. Though now governing with a minority in parliament, Mr Sharon has a solid majority for disengagement, thanks to the left-wing opposition. But he faces defeat on other issues, which hobbles his running of the country.

So he may try to stumble on, supported by the opposition Labour party on Gaza, while buying votes from religious parties in order to pass next year's budget. Or he can try again to bring Labour, headed by his friend Shimon Peres, into the government coalition—which would mean flouting the Likud party's decision against joining forces with its old adversaries. Or, as a last resort, he may call an early election.

Mr Sharon's real battle, however, will loom elsewhere. He knows that Mr Abbas, or whoever leads the Palestinians, would agree to co-operate with him over the Gaza withdrawal only if it is linked to a bigger pullout from the West Bank, so enabling a viable, contiguous Palestinian state to emerge there, along the lines of the international “road map”. That was what Britain's prime minister, Tony Blair, was to tell President Bush this week in Washington. Leaving Gaza, he says, must be only a first step. That dismays

Mr Sharon, who would like to leave Gaza but keep about half the West Bank—for a long time.

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The opposition in Israel

Might Ehud Barak come back?

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From The Economist print edition

A new opposition leader might shake things up

Reuters

Still bouncy

IT HAS been Israel's most expected comeback. Ehud Barak, prime minister from 1999 until 2001, says he wants to run the Labour party—and the country—again. He picked November 4th, the ninth anniversary of the assassination of his mentor, Yitzhak Rabin, to launch his campaign.

Mr Barak is betting on Israel having a general election next year, perhaps even before Ariel Sharon, the prime minister, implements his plan to pull Israeli troops and Jewish settlers out of the Gaza strip. Labour, he says, should give Mr Sharon an "iron bridge" to facilitate the withdrawal, in return for an agreed election date—or else offer a new plan.

Mr Barak would offer the Palestinians a wider withdrawal—not just from Gaza but also from 90% of the West Bank, keeping a number of fenced-in settlement blocks on the West Bank. That is less than he offered Yasser Arafat at Camp David in 2000.

A former commando leader and chief of staff of Israel's armed forces, Mr Barak was Israel's shortest-serving prime minister, with just 20 months in office. But it was an especially busy period. He withdrew Israeli forces from Lebanon; tried but failed to reach peace with Syria; and sought a deal with Mr Arafat at Camp David, breaking Israeli taboos by offering to leave parts of Arab-inhabited East Jerusalem as well as most of the West Bank.

But when the deal fell through and the Palestinians' current *intifada*, or uprising, broke out a few months later, he lost his job to Mr Sharon. In the eyes of many Israelis, Mr Barak had shown himself to be arrogant, too clever by half and unsteady. Since then, he has made a lot of money in business, divorced his wife and returned to an old sweetheart, and had a trademark mole taken off his face. He wants to convince Israelis he has changed his ways and learned from his mistakes.

Labour's current leaders are wary. Another former prime minister, 81-year-old Shimon Peres, who once again heads the party and is loathed by Mr Barak, is trying to fend off his challenge—and the prospect of an early general election—by joining Mr Sharon's ruling coalition. Mr Peres says Labour could have its own primary, maybe on February 6th—the fourth anniversary of Mr Barak's thrashing by Mr Sharon. Another rival for Labour's leadership, Amir Peretz, the trade unions' leader, wants to fight the newly-rich Mr Barak on social and economic issues. On November 30th Labour will decide on the date of a primary contest.

If Mr Barak wins, pollsters reckon he would find it hard to beat Mr Sharon. But he might do better against Binyamin Netanyahu, the finance minister, who is itching to displace Mr Sharon—and whom Mr Barak beat before.

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Iran

The nuclear squeeze

Nov 11th 2004
From The Economist print edition

But who is squeezing whom?

Get article background

THE course of Iran's relations with the outside world seldom runs smooth. Just when Britain, France and Germany thought they had at last won agreement from Iran to suspend its most troubling nuclear activities, so that negotiations on a broader tension-defusing deal could take place, hardliners in Tehran seemed to dig their heels in. The Europeans had been hoping to avert a showdown later this month at the International Atomic Energy Agency (IAEA) over whether Iran's nuclear transgressions should be reported to the UN Security Council. But a last-minute dispute over the scope of the suspension left it uncertain whether it would be in place in time. One of Iran's negotiating team threatened it would pull out of the Nuclear Non-Proliferation Treaty (NPT) if western countries piled on the pressure.

Nor is Iran sounding conciliatory in other ways. Its defence minister said pointedly this week that it could now mass-produce missiles (by churning them out just like cars, he joked) that it has in the past claimed are capable of striking both Israel and American bases in the Gulf. Another spokesman was reported to say that Iran had the technical know-how to build a bomb, while still denying that it had any intention of doing so. Iran appears also to have helped Hizbullah, to which it has long sent cash and arms, launch an unmanned aerial vehicle from Lebanon on a photographic mission over northern Israel. Such drones can also carry bombs.

None of this was coincidence. A previous deal that the Europeans thought they had struck a year ago with Iran to suspend its uranium and plutonium programmes unravelled when IAEA inspectors kept uncovering new evidence of Iran's nuclear cheating and Iran huffily refused to end its manufacture of parts for uranium-enrichment machines, and then went on to produce the gas that is spun in such centrifuges to produce uranium—which can be used for nuclear fuel or bombs. Since then, Iranian officials have insisted that any new suspension they agree to will be short-lived: six months at the most.

The Europeans have also taken a tough line this time: the agreement reached with Iran specifies no deadline, and they insist it must include all work towards enrichment. They will not negotiate the second element of the deal, which would include trade and political concessions to Iran, as well as offers of nuclear co-operation, while the Iranians are busily stocking up to start enrichment whenever they choose. And while Iran insists it has a right to enrich uranium under the NPT, the Europeans, pointing to past breaches of nuclear safeguards, want it to agree not to do so—as many other countries have done.

But hardliners in Iran think they hold a strong hand. Just as the Europeans are refusing to pay much up front to get Iran to reinstate the suspension of uranium enrichment that was supposed to have started a year ago, so the Iranians may calculate they need not sacrifice much to avoid referral to the UN Security Council. There, whatever the tone of the latest report from the IAEA that was being finalised this week, they hope for the blocking support of China and Russia. China has already said the issue should be handled at the IAEA, not the UN. And Russia hopes to continue its lucrative nuclear commerce with Iran, having just completed the country's first power reactor.

So even if this week's hurdles can be overcome, Iran may have no intention of pursuing real negotiations with the Europeans. Instead it could be playing for time in the hope that eventually others will tire of the issue—or while it carries on working towards nuclear break-out in ways the IAEA's inspectors don't know about.

That is the worry among Israelis and among some in the Bush administration. Israel has already hinted that, if the Iranians cannot be stopped by other means, it may consider military strikes at nuclear

facilities, similar to its raid on Iraq's Osirak reactor in 1981. Hence Iran's unveiled warnings of its ability to strike back using missiles and other means.

Such talk alarms the Europeans: Britain's foreign secretary, Jack Straw, has said it is “inconceivable” that America would strike at Iran, or give the nod to Israel to do so. America's secretary of state, Colin Powell, also recently advised Israel to rely on diplomacy rather than force.

Meanwhile the Europeans know that, if Iran is to be diverted from any nuclear weapons plans, their own inducements will not be enough. At some point America will need to join the diplomacy too. So far, with a long list of complaints about Iran's behaviour, America has refused. But just before the IAEA next takes up Iran's case, in two weeks' time, Mr Powell will have a rare chat with his Iranian counterpart at a meeting of Iraq's neighbours at the Egyptian resort of Sharm el-Sheikh. Though with both countries still in uncompromising mood, the cause of diplomacy may not advance very far.

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Côte d'Ivoire and France

A bloody mess

Nov 11th 2004 | ABIDJAN AND PARIS
From The Economist print edition

What next in a former French colony ravaged once again by war?

AP

They don't seem to appreciate their former masters

Get article background

A FRAGILE peace that had shakily endured since an agreement in July last year finally collapsed earlier this month in chaos and bloodshed. But rather than merely a resurgence of civil war between rebels in the mainly Muslim north and government forces based in the south, the latest fighting has become a three-way wrangle involving the former colony's old masters, the French. If they cannot, under their United Nations mandate, restore order fast, it will be one of their biggest embarrassments abroad for many years.

The mood had already become twitchier in September and October, when a number of deadlines previously agreed by the government and the rebels, for constitutional and legal reforms and then disarmament, were missed. Then, on November 4th, the Ivorian armed forces, which are loyal to President Laurent Gbagbo, launched a series of air raids on the rebel-held north. Guillaume Soro, leader of the New Forces, as the rebels are known, said that 85 civilians were killed.

Two days later, an Ivorian air force bombardment of the New Forces' capital, Bouaké, hit a French peacekeepers' camp, killing nine French soldiers and an American aid worker and injuring nearly 40 others. France hit back immediately, first destroying the Ivorians' two Sukhoi-25 aircraft that had carried out the raids. The French peacekeepers then blasted the rest of the Ivorian air force (a handful of helicopters), seized the international airport in Abidjan, the commercial capital in the south, and flew in reinforcements.

This enraged President Gbagbo and his supporters. Tens of thousands of them, known as the Young Patriots, took to Abidjan's streets. In the evening of November 6th they streamed towards the airport; it took shots from French soldiers and helicopters to push them back. The minister for national reconciliation, Sebastien Dano Djedje, said that 50 protesters had been killed.

Returning in frustration from the airport, the demonstrators then turned their ire on Abidjan's sizeable French community, looting houses, destroying and burning businesses and schools, and attacking people. Convoys of French tanks and armoured vehicles, some of them 50-strong, swept through the streets, lifting white expatriates to the safety of military bases.

With the war between the government and the northern rebels suspended, the Ivorian army began to pull back to where it had been before the latest round of violence. Yet the only soldiers seen on Abidjan's streets were French and UN forces—which many Ivorians found even more insulting. When some 50 French military vehicles stationed themselves beside the posh Hôtel Ivoire, near the president's residence and the state television station, rumours flew round the city that France was going to sweep President Gbagbo from power. The national assembly's speaker, who is close to Mr Gbagbo, told French radio that France was now the enemy.

State television broadcast repeated calls for the Young Patriots to form a human shield round the president's house and the television station. Several thousand more surrounded the Hôtel Ivoire, where many Europeans were holed up, shouting “Gbagbo! Gbagbo!” and “Chirac, assassin!” Clashes between French soldiers and the Young Patriots broke out. When the French decided to evacuate the hotel, where more than 1,000 Europeans had been whisked to safety, the Patriots tried to charge in. Shots were fired, either by French troops or by a detachment of the Ivorian armed forces that was supposed to cover the French evacuation. At least ten people are said to have died.

The question being asked back home in France is: what are so many French troops doing, bogged down in a chaotic West African country, where neither side—government or rebels—seems to want them? “France's little Iraq” is what one French observer calls the mess in the former colony.

Many Ivorians believe the French were behind the rebellion two years ago that still cuts the country in two. And the destruction of the Ivorian air force, coupled with shooting at largely unarmed if aggressive and often drunk demonstrators, has inflamed feelings more. It is hard to see how the French can continue, under the aegis of the UN, to be regarded as even-handed peacekeepers.

While 4,600 French (at least 600 of whom have only just arrived, to meet the emergency) and another 6,000-odd UN peacekeepers (mainly drawn from West African countries) are trying to hold the ring in Abidjan, the New Forces in the north may be tempted to strike again, to complete their unfinished business. Mr Soro said it was hard to hold his men back. “Laurent Gbagbo has chosen the military option, which means the solution to the Ivorian crisis is military,” he said grimly.

France's military commitment in Côte d'Ivoire, the world's top cocoa producer, is its biggest abroad. When French soldiers first arrived two years ago to oversee a peace brokered in Paris between Mr Gbagbo's government and the rebels, their presence was already widely regarded as provocative. The government reproached them for not helping it crush the northern insurgents, who felt robbed of their chance to press on all the way to Abidjan. Under a deal supervised by Dominique de Villepin, France's then foreign minister, a line was drawn across the country to separate the belligerents, with French soldiers stationed along it to keep them apart.

Have the French now overreacted? They stress that, before whacking Mr Gbagbo's forces last week, they got unanimous approval from the UN Security Council to take “all necessary means” to restore order. Moreover, says an aide to President Chirac, the notion that the Ivorians might have bombed the French military camp by accident is patent nonsense. Michel Barnier, France's foreign minister, described the attack as “inexplicable and unjustifiable”. Without a firm response, even worse chaos might have ensued.

This latest drama exposes the limits of France's vaunted new Africa policy. Long happy to be the continent's gendarme, propping up unsavoury friends in resource-rich countries, France has been trying

to fashion a less partisan approach. Thanks to budget pressures, the end of military conscription in 1996-97 and a new push from the previous Socialist government that “cohabited” with President Chirac in 1997-2002, France has shrunk its permanent military presence in Africa.

It has closed its base in Central African Republic, and cut the number of troops spread between bases in Djibouti, Senegal, Chad, Gabon and Côte d'Ivoire from 8,800 in 1995 to just over 6,000. While concentrating on trying to keep the peace in fewer treacherous places, it has tried to act more multilaterally. In 2003, for instance, it sent peacekeeping troops under a European Union flag to eastern Congo.

The snag is that, if the French leave now, the country could fall back into bloodier civil war. Yet, as François Heisbourg, director of the Foundation for Strategic Research, puts it, “the French presence is now seen as part of the problem rather than the solution”.

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Sudan

An agreement, sort of

Nov 11th 2004 | EL-FASHER, DARFUR
From The Economist print edition

Despite a parley between rebels and government, the brutality goes on

IT WAS not by any stretch of the imagination a real breakthrough. At the end of two weeks of knotty peace talks in Abuja, Nigeria's capital, Sudan's government promised to allow aid agencies free access to its western region of Darfur—a promise it has made and broken several times before. More important, it promised to make Darfur a military no-fly zone, so it should stop dropping barrel bombs on Darfur's villages and refugee camps and strafing them from helicopter gunships.

Alas, there are one or two reasons to doubt the government's word. It has broken previous ceasefire agreements. The government also denies its well-proven role in launching a vicious local militia, called the Janjaweed, to cleanse Darfur's villages of rebels—and of civilians. Around 70,000 Darfuris are estimated to have died since a long-standing ethnic row erupted into war in Darfur early last year. Some 1.5m have been driven from their homes, to hunker in squalid camps in Sudan or across the nearby border with Chad.

On November 10th—the day after the agreements were signed in Abuja—paramilitary police attacked a refugee camp near Nyala, in central Darfur, with tear gas and gunfire. Officials of the African Union, which brokered the talks in Abuja, remonstrated in vain with the attackers.

This was sadly typical of the AU's peacemaking effort in Darfur so far. In August, it dispatched several hundred military observers there to monitor a ceasefire. They have since observed anything but ceasefire: a glut of rape, killing and looting by the government's vicious proxies, apparently undeterred by their presence.

But the AU, which is new to peacekeeping, does seem to be getting serious. Last month, it pledged to boost its presence in Darfur to 3,320 soldiers and police. With logistical help from the United States, it has so far deployed some 700 Rwandan and Nigerian troops.

The AU's new interest in peacekeeping bodes well for future conflicts. But what difference will it make to Darfur, a remote stretch in Africa's biggest country? The AU has only a few vehicles to transport its men overland and almost no aircraft to hand. It has too few tents to shelter even its men now on the ground. And the valuable computer equipment it has been given for communications came with software and instructions written only in German, which no African there understands.

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Islamic terrorism in Europe

After Van Gogh

Nov 11th 2004 | AMSTERDAM, BRUSSELS AND PARIS
From The Economist print edition

Hollandse Hoogte

Europeans ponder how the tolerant can best deal with the intolerant

“THE *jihad* has come to the Netherlands.” That was the verdict of Jozias van Aartsen, parliamentary leader of the power-sharing Liberals (VVD), after the violence following last week's murder in Amsterdam of Theo van Gogh, a film-maker, by a Muslim radical. Attacks on mosques and Muslim schools were met by retaliatory attacks on churches. A raid on a terrorist cell in The Hague turned into a street battle featuring hand grenades and wounded policemen, before two suspects were arrested.

This sorry tale raises a big issue not just in the Netherlands, but across Europe: how far should liberal societies tolerate the intolerant? For 20 years the instinct of many has been to defend the rights and cultures of growing numbers of Muslim immigrants, even radicals. Any other approach, it was feared, would pander to racists. But both multiculturalism and tolerance are now under broad attack.

In the Netherlands, Pim Fortuyn, a gay maverick, popularised the argument that Muslim immigrants were promoting values inimical to Dutch traditions. When he was murdered in 2002, his political movement all but collapsed. But some of his arguments found a new advocate in Ayaan Hirsi Ali, a female Somali immigrant and former Muslim who is now a liberal member of parliament. She urges the Dutch to insist forcefully on the superiority of western liberal values. Ms Hirsi Ali was threatened, along with Mr Van Gogh, after they made a film together that attacked Islamic fundamentalists' treatment of women.

Voters are also turning to a new champion, Geert Wilders, a renegade member of parliament thrown out by the liberals. Polls show that his party-in-the-making might win 7-17 seats if an election were held now, largely thanks to his attacks on Islam. The government urges restraint; but it is tightening immigration controls and cracking down on Islamic extremists.

In France, Nicolas Sarkozy, now finance minister but once interior minister, commented recently that “whether I like it or not, Islam is the second biggest religion in France. So you've got to integrate it by making it more French.” His government has a two-pronged approach to its 5m-strong Muslim population. It has tried to contain the radicalism of Islamists by co-opting them. And it has used a tough security regime to curb troublemakers.

To the first end, Mr Sarkozy last year set up the French Council of the Muslim Faith, an official voice for

French Islam. When hardliners won elections to its regional branches and governing council, he said this was no disaster: it was best to bring such groups out of the shadows. Yet his strategy has had mixed results. A power-struggle rages in the council, threatening moderates. But one mark of the council's success was the reaction to the seizure in Iraq of two French journalists whose captors want the repeal of a ban on the headscarf in state schools. All shades of French Islam condemned the capture.

France has a strikingly harsh anti-terrorism policy. It has had no qualms in making the most of laws allowing the detention of terrorist suspects without trial for months on end. All four of its nationals repatriated from Guantánamo Bay were detained on a judge's instruction on their return to France. Dominique de Villepin, Mr Sarkozy's successor as interior minister, has been unyielding in his determination to expel imams guilty of hate crimes. When an expulsion order against Abdelkader Bouziane, an Algerian cleric based near Lyon, was overruled in the courts, Mr de Villepin changed the law—and Mr Bouziane was on the next plane out.

For Mr de Villepin, the trade-off between security and civil liberties is a fine one. But he insists “we must never find ourselves in a position of powerlessness.” The French monitor activity at mosques across the country, reckoning that of 1,500 Muslim prayer places, some 50 preach a radical form of Islam. This need not mean violence, but Mr de Villepin urges vigilance: “radical Islam can be used as a breeding ground for terrorism.” The French are also keen to co-operate with other European countries, fearful that their tough regime might otherwise move the problem to “softer” neighbours. With this in mind, Mr de Villepin has secured agreement with Britain, Germany, Italy and Spain to share intelligence on radical Islamists who attend training camps.

In Germany, home to 3.5m Muslims, over three times as many as the Netherlands, fears of violence and *jihad* are somewhat smaller. Admittedly, Islamic extremists could hit anywhere, but most Muslims in Germany are from Turkey (2.6m) or Bosnia (170,000), and espouse a more moderate form of Islam. Police have found few links between Islamic groups in Germany and the Netherlands. Yet Germany is not oblivious to the threat. As in France, the government is getting tougher on Islamic fundamentalists, even as it tries to foster integration. This double strategy underpins Germany's new immigration law: it facilitates the expulsion of Islamic radicals, but also makes language classes mandatory for immigrants.

In the same spirit, EU immigration ministers, meeting in the Netherlands, signed up on November 10th to common principles, both tender and tough, for integrating newcomers. They must be helped to take part in peaceful politics; faith must be respected, but not used to curb freedom.

In Germany, as elsewhere, there is now more emphasis on toughness. In October, after four years of legal manoeuvring, Germany ejected Metin Kaplan, the Turkish founder of an illegal Islamic group. There is less tolerance for radical Islamists using legal tricks to stay in Germany. The rule of law must “show its edge”, says Otto Schily, the interior minister.

After the Van Gogh murder, calls for Europe's open societies to be more aggressive towards Islamic radicals can only get louder. “Militant Islamism is only a tiny force in Europe”, wrote the conservative *Frankfurter Allgemeine Zeitung*, “yet it is dangerous, because many societies on this continent have elevated their defencelessness into a virtue.” Yet the risk is that, rather than the intolerant learning tolerance, the tolerant become intolerant too.

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Belgium's far right

Blokked

Nov 11th 2004 | BRUSSELS
From The Economist print edition

The banning of the Vlaams Blok

Get article background

WHILE the Dutch crack down on Islamic radicals, in Belgium it is white racists who are under assault. On November 9th Belgium's appeals court approved a ban on the Vlaams Blok, which campaigns against immigration and for an independent Flanders, the Dutch-speaking bit of Belgium.

The Blok and its supporters were accused of violating anti-racism laws. In the past, party leaders have advocated forcible repatriation of immigrants. For years the Blok was dismissed as a fringe party with origins among former Nazi collaborators. But it has become the most popular party in Flanders, with over 26% support in opinion polls. Mainstream parties have resisted working with the Blok, keeping it out of governments at both national and regional level. They have now managed to get the party banned.

Such measures are likely to backfire. The Blok plans to re-form, probably under the name Vlaams Belang (Flemish Interest). By setting up a new organisation, it hopes to put itself beyond the law. But the banning and the party's continuing absence from government will allow the new party to keep the outsider status that enabled the Blok to soak up the protest vote in Flanders.

Events across the border will do no harm to a party that has made fear of Muslim immigration a central part of its pitch. Filip Dewinter, co-leader of the Blok, was quick to make the connection. “In the Netherlands”, he declared, “they killed freedom of speech with bullets. In this country, they killed it in a court.”

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Human rights in Turkey

Haunted by the past

Nov 11th 2004 | ANKARA
From The Economist print edition

A human-rights commission embarrasses the government

Reuters

Wanted: a human-rights umbrella

"HAPPY is he who calls himself a Turk!" That breezy slogan, emblazoned on mountainsides and offices from the Aegean to the Euphrates, was devised by Kemal Ataturk, the founder of modern Turkey, as he set about forging a fresh identity for his people. The idea was that former subjects of the Ottoman empire—whose native language might be Arabic, Albanian or Kurdish—would find a new togetherness as citizens of a unitary republic. And in case people hesitated to embrace the joys of Turkishness, there were harsh penalties for those who asserted any other sort of identity.

For most of the past 80 years, these principles have been sacrosanct. But if Turkey is to have any hope of joining the European Union, some taboo topics of history, identity and language must be discussed openly, without fear of prosecution. In a burst of zeal three years ago, the government—led by former Islamists—set up a panel to take a broad look at questions of human rights and identity, and to suggest how things could be improved. But Turkey's masters got more than they expected. The board's report, released this month, said things that were almost unsayable, triggering a sharp backlash.

For example, the report implies that if the Lausanne treaty of 1923—the basis of the Turkish state and its foreign relations—had been fully implemented, bloodshed between Turks and Kurds might have been avoided. To justify this argument, which is explosive in Turkey, however mild it might seem elsewhere, the report cites article 39 of the treaty, which allows Turkish nationals to use "any language they wish in commerce, in public and private meetings and all types of press and publication."

It also says that articles which supposedly protect non-Muslim minorities have been read too narrowly: as well as covering Jews, Armenians and Greeks, these articles should have been applied, for example, to Syrian Orthodox Christians. More controversially still, it suggests replacing the term "Turk" with a more inclusive word to cover all ethnicities and faiths, such as "*Turkiyeli*"—"of Turkey".

It was more than some Turks could bear. Even as Ibrahim Kaboglu, the jurist who heads the board, was reading the report at a press conference, a fellow member snatched it and tore it into shreds. Both Mr Kaboglu and Baskin Oran, a political scientist who wrote the report, have been bombarded with threatening phone calls and mail. "Fraternal blood will be spilled," warned one. Another called for a military coup. Prosecutors in Ankara are investigating claims that both academics may have committed treason. Ilker Basbug, a top general, has joined the fray, saying Turkey's unity should not be tampered with. The government, frightened by the reaction, has washed its hands of the report and denied commissioning it.

It is possible, though unlikely, says Husnu Ondul, a human-rights lawyer, that the two authors may be prosecuted under an article of the new penal code approved in September, which provides for up to ten years' jail for those who engage in unspecified "activities" against the "national interest". What might such activities be? In a footnote, the law deems "anti-national" anyone who advocates withdrawing Turkish troops from Cyprus, or terming "genocide" the killing of hundreds of thousands of Armenians in 1915. If the aim was to stifle discussion of this second issue, it failed: at a conference in Venice last month, historians from all countries involved took a broader, more cool-headed look at the 1915 tragedy than would be possible in Turkey—now or, it seems, any time soon. And what about the 100,000

Turkish-Cypriots who voted (vainly) in April for a UN plan that would have removed most Turkish troops from Cyprus: was that a crime?

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Macedonia's referendum

A narrow squeak

Nov 11th 2004 | ATHENS AND SKOPJE
From The Economist print edition

The country remains at peace, largely thanks to deft American diplomacy

Get article background

THERE were sighs of relief almost everywhere, though nobody will ever know how narrow an escape from war one of Europe's most volatile states has just had—nor how big a role in hauling Macedonia back from the brink was played by the Americans. In any event, peace between the Slav Macedonian majority and the ethnic-Albanian minority is on track again. On November 10th, politicians from all sides assembled at Lake Ohrid to recommit themselves to a reconciliation process, launched on the same spot in 2001.

What made the gathering possible was the result, or rather non-result, of a referendum three days earlier, sponsored by hard-liners among the country's Slav Macedonian majority. They hoped the vote would derail a peace deal they saw as too generous to the minority. But, in the end, only 26% of the electorate—not enough for a quorum—turned out to vote. So the constitutional changes to devolve power to local authorities and to cut their number from 123 to 83, will go ahead (though the more controversial bits may be tweaked).

Only a few weeks ago, another result seemed likely. Senior American and European Union figures issued sharp warnings that the country's future was at stake. That stiffened the backs of Slav Macedonian nationalists, who seemed confident of wrecking the three-year-old peace process. What changed? America used honey instead of gall. In its first big foreign-policy move, the new Bush administration delighted Skopje by saying it would now recognise the country as the “Republic of Macedonia”. Until now, America and most other countries had used the name “Former Yugoslav Republic of Macedonia” out of deference to Greece, which fears a threat to its part of the Ottoman province of Macedonia, partitioned in 1913.

Predictably, America's move drew cries of anger in Greece, but they were restrained compared with the rage of 12 years ago when the Macedonian republic was proclaimed. At that time, a million people attended Greece's biggest-ever nationalist rally, and the government imposed a trade embargo that left Skopje short of oil and shivering.

Last week, only about 2,000 people from LAOS, an ultra-rightist party, attended a protest rally in Thessaloniki; a small neo-Nazi group burned an American and a Macedonian flag. If Greece is restraining its ire, it may be because it has little reason to fear its neighbour. Greeks have become the biggest investors in Macedonia. An Athens-based firm owns the oil refinery there and has built a pipeline from Thessaloniki to Skopje. The biggest Macedonian bank, a leading supermarket chain and a mobile-phone operator are all controlled by Greek interests.

Some Balkan-watchers were struck by the sophistication of America's tactics at a time when most eyes in Washington are fixed on the Middle East. If some senior Americans are focusing on the Balkans, further diplomatic moves—including on the future of Kosovo—may lie in store.

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Spanish television

Plumbing the depths

Nov 11th 2004 | MADRID
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A forlorn effort to get rid of rubbish on Spanish TV

"HOW much deeper can gossip programmes plunge, with their libel-ridden, rumour-mongering, humiliation and lying?" the newspaper *El País* asked recently. Spain's three main broadcasters pump out an average of 13 hours a day of *programas de corazón*: a blend of scurrility, plunging neck-lines and shouting. One review showed that, even as TV programmes in other countries were discussing Yasser Arafat's health or Iraq, their Spanish counterparts were ruminating on things ranging from the size of a parliamentarian's penis to whether certain pop singers were on Viagra or were extraterrestrials.

Telebasura (telerubbish) was hotly debated in March's elections. Now the Socialist government of José Luis Rodríguez Zapatero is leading a charge against it. The government has met Spain's main broadcasters to draft a code of conduct on what may be shown in the "children's timetable" (6am to 10pm) and to limit gossip shows. Spain is the only big European country with no official body monitoring what is aired.

Polls show that television is the institution least trusted by Spaniards. They have more confidence in trade unions, the church and even political parties. Zapping through Spain's TV channels, one can see why. "*Aquí hay Tomate*", a chat show, accuses a well-known businessman of drug-dealing. Much is made of the death of Carmen Ordóñez, a life-long figure in bullfighting whose body was found in a bath earlier this year. On one gossip show a friend is accused of finding her dead body, dressing it and sticking it in the bath. Another guest is subjected to a truth test about her own claimed conquests of bullfighters.

The private TV companies say they will not give up freedom easily; some detect Francoist repression at work. The president of Tele 5, Alejandro Echeverria, says "it seems like old times of the *Movimiento* and *Radio Nacional*." He says his company can control itself: last year Tele 5 fired several producers after it broadcast a sexually explicit day-time debate with a porn actor, a stripper and an erotic confectioner. But Josep María Mainat, boss of Gestmusic Endemol, producer of "*Gran Hermano*" (Spain's "Big Brother") and "*Crónicas Marcianas*", a late-night show, says that "splendid people watch these programmes, the most wholesome in the country. They are young, urban and not all uneducated. What is rubbish is what appears in the news. I would prefer 24 hours of *telebasura* to one minute of censorship."

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Charlemagne

A European superpower

Nov 11th 2004
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Might George Bush be a handmaiden in the building of a European superpower?

AFTER the shock of George Bush's re-election, Europe's elite is taking comfort in a new cliché. “The second Bush administration”, it suggests, “could be the greatest boost to European federalism since the cold war.” Most polls across Europe showed strong support for John Kerry, with Poland the only European country to plump for Mr Bush. Now that the bogeyman is back with a stronger mandate, those Europeans arguing for a declaration of independence from America have also had a boost. It was not hard to decode last week's statement by Jacques Chirac, France's president, that, after the American election, Europe has “more need than ever to reinforce its unity and dynamism.” In similar vein, José Luis Rodríguez Zapatero, Spain's prime minister, told *Der Spiegel* that “Europe must have faith in the prospect of becoming the most important global power in 20 years.”

Such exhortations are liable to be scoffed at on the other side of the Atlantic. The Europe that Mr Zapatero aspires to see as a world leader is a continent stuck with a growth rate that is feeble compared with America's, let alone China's and India's. An ageing and shrinking population hardly promises a better future. European military might remains relatively puny, while the technological gap with the United States is growing.

Yet for all this, it would be unwise for Americans to dismiss the idea that the European Union could ever emerge as an alternative superpower. Some elements are already there; others are nascent. As Adam Posen of the Institute for International Economics in Washington, DC, points out in a recent paper, after the enlargement of the EU to 25 countries earlier this year “Europe has finally caught up to the United States in economic size. Both economies at present have an annual income of around $11 trillion.” Mr Posen reckons, however, that this will be a “fleeting equality” (his paper can be found at www.brookings.edu/fp/cuse/analysis/). Projecting forward to 2020, he finds that, even on the most optimistic set of assumptions, the EU economy would then be 7% smaller than that of the United States. Take a more pessimistic scenario and the gap could be 20%.

But Mr Posen leaves an important factor out of his calculations: the prospect of further enlargement. The EU of 25 already has 455m inhabitants, compared with 295m Americans. By 2020, it is quite plausible that the EU will have admitted Turkey and all the Balkan countries, pushing its population close to 600m. The newcomers will not be rich, but experience suggests that they will grow fast once EU membership becomes a realistic prospect. The EU could thus expand its economic might simply by continually adding new members, even if that looks a bit like arithmetical sleight of hand.

Neither a large output nor a large population guarantees that the EU will be able to project power, however. Indeed enlargement could make this task harder by making the EU increasingly unmanageable. Traditional European federalists are already worried that an enlarged EU could degenerate into little more than a talking-shop. Much will depend on how far EU members believe that they share common interests.

It is here that Mr Bush may play a role as an inadvertent federaliser. Rising levels of hostility in Europe to American “unilateralism”—and a feeling (however premature) that America has failed in Iraq—are feeding popular demands for the creation of a European counterweight to the United States. Even before Mr Bush's re-election, this sentiment was reflected in pan-European polls. In June, the German Marshall Fund found widespread support for the idea that “the European Union should become a superpower like the United States”. Perhaps unsurprisingly, this notion commanded 83% support in France. But it also got over 50% support in Britain and Poland.

Even if the Europeans had the will and the economic muscle to achieve superpower status, there would still be a big gap between ambition and reality. Ancient national rivalries within Europe lurk beneath the

surface, and they tend to bubble up at times of international crisis: witness the splits over Iraq and before that over the Balkans. Even in less heated times, EU countries show a marked tendency to talk European but to act national. For instance, France and Britain will not countenance any talk of replacing their national seats on the UN Security Council with a single EU seat. Germany's attempt to get its own permanent membership of the Security Council is being opposed by Spain and Italy—in the name of Europe, naturally.

George Bush, recruiting sergeant

Yet taking a snapshot of the situation in 2004 and assuming it will remain forever unchanged could be misleading. For the first 30 years of its existence, the European Economic Community had no serious role in foreign policy at all. Now attempts to shape a common foreign policy are a big part of the EU's business. If the new constitution is ratified, the Union will acquire its own foreign minister and diplomatic corps. And whereas there have been high-profile debacles, particularly over Iraq, the EU's common foreign policy is making its presence felt in other areas.

The foreign ministers of Britain, France and Germany also seem optimistic that they have achieved a breakthrough in limiting Iran's nuclear ambitions. And the Europeans were highly influential in persuading Russia to sign up to the Kyoto Protocol on climate change, against the wishes of the Americans. Europe is even beginning to get its act together militarily. In December the EU will take over the military operation in Bosnia from NATO, a development treated with some suspicion in Washington.

European federalists hope that, over the next four years, Mr Bush will continue to serve as a recruiting sergeant for their cause. But they may need to seize their moment. In a generation's time, the rise of China, or radical Islam, or something else, may make efforts to depict America as a bogeyman that needs a counterweight seem deluded and frivolous.

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Human rights law

The menace that wasn't

Nov 11th 2004
From The Economist print edition

The Human Rights Act has not lived up to expectations. Good

TAKE a common law system steeped in precedent and tradition and add a dash of fundamental rights. What do you get? Four years ago, Jack Straw, then the home secretary, made a confident prediction. By incorporating the European Convention on Human Rights (ECHR) into English law, he claimed, the nation would acquire something like America's Bill of Rights. Public authorities and the government would henceforth be bound by a “fairness guarantee” and would no longer be able to treat ordinary citizens according to whim. More than that, a Human Rights Act would create universal values for all and “act as a compass as society moves through the uncharted waters created by global change”.

A less benign, but equally confident, view is that the human rights compass has led Britain astray. Tabloid newspapers report that the Human Rights Act has brought nothing but chaos. Undesirable minorities such as asylum-seekers, gypsies and prisoners are said to have harnessed innocent-seeming “rights” to liberty and family life in such a way as to trample everyone else's liberties. Ever on the lookout for an issue with popular traction, the Conservative Party has pledged to review the Human Rights Act with the strong hint that some of its provisions will be undone.

This is splendid politics, but the problem is that the incorporation of the ECHR into domestic law has not come close to meeting reformers' hopes—nor has it confirmed conservative fears. “It has been a bit like the millennium bug,” says Luke Clements, who follows human rights law at Cardiff University. Even Dominic Grieve, the Conservative shadow attorney-general, concedes: “the view was that it was going to lead to a legal free-for-all, and I don't think that has happened.”

A count of cases heard in the high courts of England and Wales between 2000 and 2002 found that human rights claims were considered in 431 cases and upheld in just 94. Keir Starmer, a barrister who contributed to the study, says things have moved on since then: he has four appeals pending, all of which involve human rights in some way. But just because judges now have a new standard by which to assess the claims of plaintiffs doesn't mean they will reach a different decision. “Hand on heart”, Mr Starmer says, the Human Rights Act has changed the outcome of only a very few cases.

That is partly because the common law turned out to be more accommodating than many reformers or traditionalists suspected. Four years ago, some feared that, because Britain lacks a written constitution or bill of rights, the stark language of the ECHR would sweep aside centuries of legal precedent. Faced with a potential clash between two traditions, though, judges have simply declared them to be complementary, or even claimed that the ECHR“reveals” ambient human-rights principles in the common law.

For the most part, such philosophical niceties are unnecessary. Away from the high courts and the few London legal chambers that specialise in human rights cases, ECHR principles are rarely invoked. When they are, says Tony Kershaw, the principal solicitor at West Sussex county council, they are invariably “bolted on” to mundane claims in order to make them seem more solid. “No lawyer can hope to win a case based solely on human rights,” he believes.

That holds true even for lawyers representing gypsies and travellers, who often assert the right to private and family life when facing eviction from illegally occupied land. Chris Johnson, a solicitor who represents gypsies, says that many people (including his clients) believe cases are transformed by “a sprinkling of magic human-rights dust”. They are usually disappointed. The Human Rights Act has neither enabled more cases to be brought, nor made them much easier to win, since judges are still obliged to weigh individual rights against the common good. Even when decisions go the gypsies' way, they turn out to have limited application. Mr Johnson believes that a new planning bill will have a greater effect than all

the court cases put together.

On the rare occasions when human rights have upset the apple cart there was usually a pressing need for change. A good example is privacy law: cases brought by Naomi Campbell, a model, and Princess Caroline of Monaco have recently jeopardised the trade in paparazzi photographs. Legislation could swiftly resolve the issue one way or the other, but the government is loth to cross the newspapers. So human rights law must clean up the mess.

Even in Westminster the Human Rights Act has been domesticated. Every item of legislation is now scrutinised by the Joint Committee on Human Rights to see if it complies with the ECHR. Some of the Home Office's wilder initiatives—such as a proposal to deny housing to asylum-seekers unless they do community work—have failed that test. But what looks like a clash between parliamentary sovereignty and fundamental rights is in fact just a new front in an old political battle. As Lord Lester, a committee member and a long-time campaigner for human rights, puts it, the committee supplies weapons—in the form of critical reports—which other parliamentarians use to attack legislation.

The mythical status of the Human Rights Act is such that almost every unpopular decision is now blamed on it. But Mr Clements, at Cardiff, believes there may be a more mundane explanation for the liberal drift in judicial thinking: staff turnover. “These days,” he says, “there are simply more right-wing judges than very right-wing judges.”

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Muslim radio

Mecca calling

Nov 11th 2004
From The Economist print edition

The rise of Radio Ramadan

URBAN Britons trawling the FM dial over the past month would be forgiven for thinking that Islamic revolutionaries had seized control of the airwaves. A month ago not one Muslim radio station was broadcasting in Britain; at present, 33 are doing so.

During Ramadan, when religious and communal feeling is strongest, these stations pump out a stream of sermons, discussion and Islamic songs, punctuated by advertisements for curry houses and jewellery stores. Quality is patchy, but coverage is not. Ramadan radio stations are in all the predictable places—London, Manchester, Bradford—but there is also a Radio Ramzan High Wycombe and a Ramadhan Radio Dundee.

“Run properly, it is a lucrative business,” says Sajid Quayam of Radio Ramadhan Glasgow. He reckons a station can get off the ground for as little as £7,000-8,000 ($13,000-15,000); the short-term Restrictive Service Licences under which the stations operate cost just £84 a day. But advertising from pious business owners and diversity-minded employers can bring in many times that. Hence the growth in stations (numbers are up by a third since 2001) and fiercer competition. This year, 58 outfits applied to run Bradford's station.

Immigration has made Britain's Muslim population more diverse in recent years, which presents problems for the radio stations. This year, Ramadan FM Leicester is broadcasting in English, Urdu, Gujarati, Punjabi, Bengali, Somali and Arabic. In East London, though, the diversity of tongues has simply become too much. “You can't win,” says Zahid Amin, a director at Radio Ummah, which also broadcasts online. “You might as well go with English.” Radio Ummah has added more current affairs programmes and debates in response to demand from listeners and callers, about three-fifths of whom are women, according to Mr Amin.

All this is welcome, and not just because it makes the airwaves more interesting. In and out of government, there is increasing concern about Britain's Muslims. Worriers are especially focused on lack of English skills, paucity of viable businesses, and the failure to create an inclusive, British Islamic identity. For one month a year, though, the airwaves offer a way for Muslims to address their own problems.

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Gypsies

Misfortune telling

Nov 11th 2004 | NORTH CURRY, SOMERSET
From The Economist print edition

Why fewer legal sites for gypsies mean more cross villagers

NORTH CURRY sits on a small hill in the middle of a particularly flat part of Somerset. There is only one shop in the village, but no shortage of money: one cutesy thatched cottage has two Mercedes cars parked in the driveway. There is a fine medieval church whose door is never locked. And, as of two weeks ago, there is also a large gypsy settlement. It appeared overnight on a field bought by gypsies from a farmer, who is now full of remorse. "I feel really sorry for the neighbours," he told the local paper.

In some ways the new arrivals fit in well: they are definitely members of the gypsy *haute bourgeoisie*. New fencing encloses 4X4s with large caravans in tow. Brass plaques with house numbers are screwed to each gate. A pair of mock-Victorian street lamps flanks one caravan. The police, who also operate from a caravan, since their local station was closed, say they have had no complaints about crime.

Some groups of gypsies do plague their neighbours, though. Andrew Ashwin, who lives near another settlement in Somerset, recently found some gypsy children playing on the swings in his garden. He asked them to budge, and the next day some people came round carrying baseball bats. Even those who pose no physical threat can do fiscal damage. Michael Dukes of Greenslade Taylor Hunt, an estate agent, reckons that all the houses within 150 metres of the North Curry site are now worth 10% less.

Illegal sites have sprung up because there is nowhere else for gypsies to go. State provision of campsites has been on the slide since 1994, when a new law took away the duty of councils to provide pitches for gypsies. Private sites with planning permission have not multiplied fast enough to meet demand.

One reason for this is that the number of gypsy caravans has steadily increased. Another is that roughly 80% of planning applications from gypsies get turned down, compared with 10% made by "the settled community", as the people who study gypsies refer to anyone whose home does not have wheels. Planning applications from gypsies tend to result in unusually well-attended public meetings, where planners are faced with a few hundred locals all saying no.

As a result, more illegal sites have appeared in the last few years. Many have followed the same pattern as the one in North Curry: gypsies buy land, occupy it, and then submit an application for retrospective planning permission. If they decide to pursue a planning decision all the way to the High Court, as happened this week at the Smithey Fen site in Cambridgeshire, this process can take a couple of years to work through. That buys enough time to settle down for a while. And the planners might even give their permission, in which case the site becomes permanent.

Should the taxpayer pay up to prevent more illegal sites? Ethics aside, there are some practical reasons for saying yes. Illegal sites come with two big costs. First, it is impossible to control their size, so illegal sites tend to be bigger and more disruptive. Legal sites, by contrast, can limit the number of caravans allowed. Second, unauthorised caravans are expensive to move on and clear up after. One study puts this cost at an average of £3,000 per caravan every year. Even the dimmest clairvoyant can see that makes no sense.

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Smoking

Stubbing it out

Nov 11th 2004
From The Economist print edition

What effect will Scotland's smoking ban have?

Reuters

What a drag

IT WAS a radical, sweeping and entirely expected move. On November 10th the Scottish cabinet voted to follow Ireland, New York and Norway in banning smoking in public places, including pubs, restaurants and even private members' clubs.

The Scottish Executive argues that Scotland is one of the unhealthiest nations in Europe, and smoking is partly to blame. Some 31% of Scots smoke, compared with 26% of Britons. Lung cancer rates are 49% higher in Scotland than in the rest of the country. Jack McConnell, Scotland's first minister, says that cigarette sales in New York fell by 13% after a ban was introduced in 2003, and by 16% in Ireland, which brought one in earlier this year.

Whether the public is as keen as its leaders is less clear. The Scottish Executive insists that there is support for a total ban, but a leaked internal poll indicated that only half the population was in favour. A different poll, conducted by Populus for the pro-smoking group Forest, found that 73% opposed an outright ban; most favoured a compromise of some sort.

Nor is the likely impact on Scottish business any clearer. The Licensed Traders' Association, which represents Scottish pubs, predicted 30,000 jobs would go. Nonsense, said the government.

Evidence from overseas sheds little light. After the ban in Ireland, the Irish Brewers' Association reported a 6% decline in beer sales in pubs. But the Irish are among the heaviest drinkers in Europe, and sales fell by a similar amount in 2003, before the ban. So the decline may be part of a long-term trend. The Vintners' Association, which represents Dublin pubs, says it has clearer statistics: it reckons that trade is down about 16%, and that about 2,000 jobs have gone.

Anti-smoking groups prefer to point to New York, where a government study reported that bars and restaurants had hired 2,800 extra staff to cope with increased demand in the wake of the ban there. But the New York Nightlife Association, a trade body, points out that the study covered workers in fast-food restaurants that had never allowed smoking on their premises, even before the ban. It reckons that employment has fallen by 10%—although the number of people applying for a licence to run a bar has stayed the same.

Smokers will now turn their attention to England, which has been toying with the idea of a ban for some time. Ministers there are thought to be reluctant to ban smoking outright, especially with a general election looming, but new health proposals dealing with the subject are due before the end of the year. No doubt the English ministers will be studying the Scottish debate closely.

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Manholes

Holed up

Nov 11th 2004
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An odd business, and an odder hobby

A LUMP of cast-iron embedded in the street is like money lying on the pavement to the seasoned eye. It takes just 20 seconds' work to lift a drain grating or manhole cover into the back of a van. Rocketing scrap metal prices mean they are worth £5-7 each, so a few hours of piracy brings a tidy profit. The cost to the taxpayer is much greater: officials in Newham, in east London, which has lost 260 covers and gratings in recent weeks, put the cost of replacement at £60,000 ($110,000).

Luckily, nobody has been hurt by falling down the holes, although that is sadly the case in other, poorer countries where such thievery is more common. But it is a growing problem. As well as Newham, councils in Gloucester, Aberdeen, Fife, Lincolnshire and Norfolk have had to deal with metal thieves this year.

One answer is closed-circuit television (CCTV), which is spreading fast in Britain. “We are sure that these thieves are locals—they know which streets have CCTV, and avoid them,” says a spokeswoman for Newham Council. Another is to use modern street fittings, which are attached by hinges rather than lifting out completely.

Sadly, it is the oldest and most beautiful street fittings that are the most valuable. That is not because of collectors' mania: drainspotters, as they are known, prefer to admire the objects of their affection *in situ*: off the street, the lovely greasy patina turns to rust. But old fittings are about a third heavier: modern casting technology produces versions weighing as little as 40kg, rather than a lucrative 55kg or more for old-style cast-iron models.

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Offshoring

The rich world's Bangalore

Nov 11th 2004
From The Economist print edition

How Britain gains from offshoring

AMERICA'S loud debate about offshoring has its echo in Britain, and the volume of argument rose this week on the publication of two reports. One was gloomy and one optimistic, so they looked at first sight contradictory. On closer inspection, though, their conclusions proved compatible.

On November 8th, the Confederation of British Industry said that companies face growing pressure to relocate parts of their business overseas. A survey of 150 firms revealed that 30% already do some of their work offshore and a further 23% are considering doing so. Supporting evidence emerged the next day, when Lloyds TSB, a bank employing 77,000 people in Britain, said that it expected to have as many as 2,500 jobs—including a call-centre in Mumbai which is replacing one in Newcastle—located in India by the end of next year. That's up from 1,500 at present.

The loss of call-centre jobs is a particular worry in Britain's less prosperous regions. Call-centres currently employ around 500,000 people. Their rapid growth in the past decade has been a lifeline to many run-down manufacturing areas that have suffered a haemorrhage of industrial employment.

It is not just relatively low skilled call-centre jobs that now appear vulnerable to offshoring. Professionals increasingly fear that their jobs will be relocated away from Britain. Cheaper communications and advances in computer technology are allowing service-sector companies to move more and more sophisticated activities to cheaper overseas locations.

But the story is not as simple as is sometimes suggested, points out a new report from the Advanced Institute of Management Research. The study focused on the offshoring of business services, a part of the economy that includes call-centres and much else besides, such as software and management consultancy, accountancy and marketing. The sector has flourished in the past 20 years as companies have increasingly outsourced operations. And Britain has benefited from this.

Offshoring doesn't just mean jobs are leaving Britain. Some are being created. Losses from British companies sending work to places such as India have been outweighed by gains from foreign companies sending work to Britain. As a result, exports of business services have grown faster than imports since 1995. Indeed Britain chalks up the world's biggest trade surplus in business services (see chart).

If Britain is to retain its edge in business services, its companies will need to do more rather than less offshoring. In order to remain competitive, they need to do as much as possible in the cheapest locations possible without loss of quality. This will mean losing lower-skilled jobs, but that loss will eventually be offset by a gain in higher-paid jobs as British firms specialise further in higher-value and more innovative services. Just as London has continued to thrive as a financial centre despite competition from cheaper locations, so Britain's business services will continue to prosper in the age of offshoring.

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Economic prospects

Pain later

Nov 11th 2004
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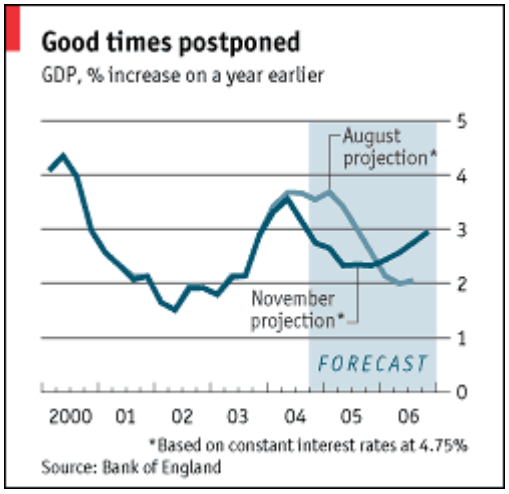
Interest rates are likely to stay at 4.75% for some time



WHEN the Bank of England raised interest rates to 4.75% in August, the City was expecting them to reach 5.0% this month. Instead the Bank's monetary-policy committee left them unchanged when it met on November 4th. Judging by its quarterly *Inflation Report*, they'll stay that way for the next few months.

One reason is that the economy has already slowed markedly in the third quarter. This is likely to prove a temporary "soft patch", but the Bank has also become gloomier about the growth outlook in 2005. In August, it projected a rapid expansion in the first half of next year, but it is now predicting quite a pronounced slowdown to around 2.5% (see chart).

With growth more subdued over the next year, there will be less pressure on capacity. As a result, the Bank has edged down its forecast for consumer-price inflation over the next two years. Inflation is currently extremely low: consumer prices rose by only 1.1% in the year to September. The Bank now thinks that, with rates on hold at 4.75%, inflation will reach the government's target of 2.0% only at the end of 2006. In August, it forecast that on the same assumption of unchanged interest rates, inflation would already be above the target in the third quarter of 2006.

It would be premature to conclude that interest rates have now peaked at just 4.75%. Although growth will be lower in 2005, it is forecast to be stronger in 2006. The Bank says that the overall increase in GDP over the next two years will be broadly the same as it projected three months ago. Looking further ahead to 2007, the Bank sees inflation rising above the 2.0% target. That may seem a long way off but it takes about 18-24 months for interest-rate changes to have their maximum effect on inflation. This suggests that the Bank may need to tweak interest rates up again some time in 2005.

Although a further hike in interest rates cannot be ruled out, the Bank itself gives warning that the risks to growth and inflation are on the down side. The major risk that it identifies is the housing market. The Bank's central projection for the economy already incorporates some modest falls in house prices—the first time the Bank has made this prediction. But it also takes into account the fact that the link between house prices and consumer spending has weakened in recent years. This suggests that a downturn in the housing market should not cause too much economic pain.

But the Bank has two worries. The first is that the setback to the housing market may turn out to be more serious than it expects in its central forecast. The second is that the historic link between house prices and consumer spending may reassert itself. If both happened, the downturn in the housing market would make a bigger dent in GDP growth.

Arguably the biggest uncertainty is whether inflation will remain so subdued in an economy operating close to full capacity. Wage growth is tame considering how low unemployment is. Much depends upon whether fierce competition among retailers will continue to keep prices down in the shops. But unless there is an inflationary surprise, interest rates are unlikely to move up much, if at all.

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Liberal Democrats

Back to the centre

Nov 11th 2004
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The Lib Dems used to be the centre party. Now they want to be it again

IT MAY not sound dramatic, but for the Liberal Democrats it will mark a critical break with the recent past. The Lib Dems, who have prospered by positioning themselves to Labour's left, are about to declare a policy of strict neutrality as far as their bigger rivals are concerned. This means that in the event of a hung parliament after the general election, the Lib Dems would negotiate even-handedly with both Labour and the Tories. They wouldn't be looking to join a coalition with either party, but would be prepared to support a limited programme before a new election could be held.

To many Lib Dem activists, the mere idea of sustaining a Tory government is shocking. As well as being the only major party to oppose the Iraq war, the Lib Dems often sound like the last defenders of unreformed public services and, at least until a year or so ago, took pride in promising to tax and spend more than Labour. In many parts of the country Labour and Lib Dem voters have informally combined to defeat Conservative candidates. The previous Lib Dem leader, Paddy (now Lord) Ashdown, and Tony Blair talked about how Labour and the Lib Dems might ally to keep the Tories out of office for ever.

So what's going on? Partly, electoral tactics. In the past few elections, the Lib Dems have done well mainly at the expense of the Tories. But they attribute much of their current popularity—their average poll rating, in the low 20s, is about five points higher than at the same stage in the last parliament—to anger over Iraq. As a result, they are now hoping to snag a number of Labour seats as well and that means wooing Conservative voters in those constituencies. They reckon that there are plenty of anti-war Tories who might vote Lib Dem, but not if they thought the party was planning to prop up Mr Blair.

But there's something else going on as well. Party strategists have been growing uncomfortable with the tag of being to the left of Labour. They have started thinking about politics after Mr Blair has quit the scene and, in particular, the likelihood that Labour will shift left. If that happens, they would be better placed if they have reclaimed the centre ground that Mr Blair captured a decade ago.

To that end, the Lib Dem leader, Charles Kennedy, egged on by more gung-ho colleagues, such as Vince Cable and Mark Oaten, the treasury and home affairs spokesmen, is trying gently to steer the party away from its more statist instincts. “The Orange Book”, a collection of essays rejecting “nanny-state liberalism”, caused a bit of a stir before the party's conference in September. The consensual Mr Kennedy wasn't pleased by the distraction and he does not fully share the enthusiasm for markets of the book's authors. But he does broadly agree that the party should be moving in that direction.

Party members may be shocked and voters not entirely convinced. But what better way for the Lib Dems to publicise their return to the centre than to announce, just before an election, their equidistance from both Labour and the Tories?

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Devolution

The end of Prescottism

Nov 11th 2004
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The death of regional assemblies has killed off John Prescott's agenda

Get article background

THE deputy prime minister is often portrayed as a fool, but, as the only Blair loyalist with deep roots in the old left, John Prescott is useful to the prime minister. He comes at a price, though: his expensive and disruptive regional policy.

Mr Prescott has set up quangos in the English regions to run development, housing, transport and the arts. They have serious money: the Regional Development Agencies alone spend £1.8 billion a year. These quangos were to be given democratic legitimacy by elected regional assemblies. The results of the referendum on the first of these, to be set up in the north-east, came through on November 5th. It was rejected so massively that Mr Prescott announced afterwards that similar planned polls in the north-west and Yorkshire have been scrapped. His regional agenda is, as a result, in tatters.

The scale of the rejection—78% voted “no”—was as stunning as the fact that 48%—well above the usual turnout in local council elections and mayoral referendums—bothered to vote. “We completely under-estimated the resentment against politicians and the political process,” says a Prescott aide. “No” campaigners pointed to the £431m cost of the Scottish Parliament's new building and claimed a north-east assembly would be equally profligate.

But John Curtice of Strathclyde University says that the marginal increase in distrust of politicians is too small to explain why the government won the 1998 London mayoral referendum but lost the north-east referendum. He argues that support for regional devolution in England was never strong enough to persuade people to suspend their scepticism about politicians—especially for a scheme as weak as Mr Prescott's.

The problem now is how to give regional quangos democratic legitimacy. Tony Blair hopes to revive local politics through elected mayors, but that neither solves the regional problem nor arouses much enthusiasm: 30 places have held mayoral referendums since 2001, only 11 have opted to elect a mayor and none of them is a big city. Anyway, Mr Prescott has never thought much of mayors.

The Conservatives have spotted the weakness. Michael Howard, the Tory leader, said on November 10th that unelected regional assemblies, set up as a precursor to elected bodies, should be abolished. They have caused uproar among county councils in the south-east by ordering big increases in housebuilding. Bernard Jenkin, shadow regions secretary, says he wants to go further and reinvent civic Conservatism by decentralising power to city and county councils. If he comes up with a convincing agenda, he might just give Mr Blair a real headache.

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Bagehot

The awful truth

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Tony Blair is not George Bush's poodle. It's much worse than that

ON THE night of the American election, Tony Blair went to bed at 10.30pm. Like nearly everyone else, he thought that John Kerry had won. But unlike the rest of the British political establishment he was not celebrating. Nor, it is fairly safe to say, was he nearly so glum when he rose at 5.30am to discover that he would, after all, be working with George Bush for another four years (always assuming Mr Blair surmounts the little hurdle of his own re-election). Until his memoirs are published, Mr Blair will not divulge just how pleased he was. All he will say for now is that he was not particularly surprised by the result.

The prime minister's equanimity contrasts with the deep gloom that has settled on most of political London—not least on Mr Blair's own aides and senior ministers. Nothing, not even the Iraq war itself, has discomfited Mr Blair's party more than his unapologetic closeness to Mr Bush. The idea that a Kerry presidency would do much to “draw the poison” from Iraq has become a cliché in Westminster. For Mr Blair's colleagues, the possibility that he might have helped Mr Bush to win, albeit indirectly, is almost too ghastly to contemplate.

Faced with the awful reality of four more years of Mr Bush, Mr Blair's establishment critics have returned to a favourite theme. If Mr Blair is such a valued ally of the president, isn't it about time that he got something tangible to show for it? When Downing Street announced that Mr Blair would be spending Thursday and Friday of this week huddled in conversation with Mr Bush, the reaction was predictably sour. This was Mr Blair's reward for his slavish loyalty to the president's ill-conceived war on terror, but unless he returned from Washington with some grand concession, it would do him little good. Rather, it would just be another embarrassing bout of “poodleism”, coming, moreover, at a time when anti-war sentiment is being fuelled by the daily attacks on the Black Watch regiment by Sunni suicide-bombers.

The kind of thing that Mr Blair is supposed to demand Mr Bush spend his newly acquired political capital on comes from an equally predictable wish-list: a re-energised Middle East peace process; a rapprochement with European opponents of the Iraq war; the repatriation of the remaining British prisoners in Guantánamo Bay; a change of heart over global warming. If Mr Blair were to come back empty-handed, say the prime minister's critics, his only option would be to put some much-needed distance between himself and Mr Bush before the general election. A currently fashionable theory is that the president, painfully aware how his friendship has diminished the prime minister in the eyes of British voters, would not take offence if Mr Blair engineered a row with him.

One of them

This is to misunderstand Mr Blair. He would not seek to misrepresent his relationship with Mr Bush because he is not ashamed of it. He refuses to demand a *quid pro quo* for backing America in Iraq because he believes that the war was right. He is convinced that supporting it, and Mr Bush, was in Britain's interest.

The prize for being a trusted ally, in Mr Blair's view, is not a goody-bag of concessions to take home with him, but the chance to feed in ideas as the second-term administration makes its plans. His working assumption is that both sides have shared interests even if they may at times have differing thoughts about how to serve them. In Mr Blair's view, this is not a zero-sum haggle in which items on a British agenda are traded off against items on an American one. With Mr Bush, he prefers not to negotiate in the normal sense of the term. He expects the president to recommit to the Middle East peace process not as a favour, but because Mr Bush can be persuaded it is in his interest to do so.

That Mr Blair gets such a hearing is not simply because he has earned it by sending thousands of British troops to Iraq. It is because Mr Bush sees in the British prime minister a kindred spirit. So also do leading American neo-conservatives, such as Irwin Stelzer and William Kristol, both of whom recently turned up in London to claim Mr Blair as one of their own. They have both argued that Mr Blair was a neo-con before September 11th and before Mr Bush became one. Mr Blair's neo-conservatism, they imply, may be purer and deeper than Mr Bush's.

What distinguishes the neo-con approach to foreign policy is the conviction that, by and large, democracies don't go to war with each other; and that powerful countries have both an interest and a moral duty to increase the number of democratic governments in the world. Neo-cons don't think only about defending interests, but also about extending values. In an interview given to the *Times* just after the American election, Mr Blair went out of his way to confirm what Messrs Stelzer and Kristol had said: “When the Americans say we want to extend...democracy and human rights throughout the Middle East... people say, well, that is part of the neo-conservative agenda. Actually, if you put it in different language, it is a progressive agenda.”

This is going much further than a simple creed of liberal interventionism for humanitarian purposes. While there may be many ways of extending democracy to other countries, the neo-cons are unabashed about being willing to use military force to do so. During the Kosovo campaign in 1999, Mr Blair made it clear that winning the conflict was important both because of the message it would send to other dictators and because it would provide a template for action in the future.

The awful truth is that Mr Blair goes along with these ideas not because it's expedient, but because he believes them. It's no wonder that he feels comfortable with Mr Bush and more appreciated in Washington than at home. It's also not surprising that his neo-con passion strikes fear into Labour, while Conservatives of the non-neo sort look on with incredulity.

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A world of work

Nov 11th 2004
From The Economist print edition

The global deployment of work has its critics, but it holds huge opportunities for rich and poor countries alike, says Ben Edwards

ON A technology campus off the bustle of the Hosur Road in Electronics City, Bangalore, engineers are fiddling with the innards of a 65-inch television, destined for American shops in 2006. The boffins in the white lab coats work for Wipro, an Indian technology company. Wipro has a research-and-development contract with a firm called Brillian, an American company based half a world away in Tempe, Arizona. Brillian's expertise is in display technology. Wipro's job is to put together the bits that will turn Brillian's technology into a top-end TV.

Wipro is sourcing the television's bits and pieces from companies in America, Japan, Taiwan and South Korea. After design and testing, assembly will pass to a specialist contract manufacturer, such as Flextronics or Solectron. The buyer of the finished television might use a credit card administered from Kuala Lumpur, Malaysia. After-sales service might be provided by a polite young Indian call-centre agent, trained in stress management and taught how to aspirate her Ps the American way.

A few years ago, the combination of technology and management know-how that makes this global network of relationships possible would have been celebrated as a wonder of the new economy. Today, the reaction tends to be less exuberant. The same forces of globalisation that pushed Flextronics into China and its share price into the stratosphere in the 1990s are now blamed for the relentless export of manufacturing jobs from rich to poorer countries. Brillian's use of Indian engineers is no longer seen as a sign of the admirable flexibility of a fast-growing tech firm, but as a depressing commentary on the West's declining competitiveness in engineering skills. The fibre-optic cable running between America and India that used to be hailed as futuristic transport for the digital economy is now seen as a giant pipe down which jobs are disappearing as fast as America's greedy and unpatriotic bosses can shovel them.

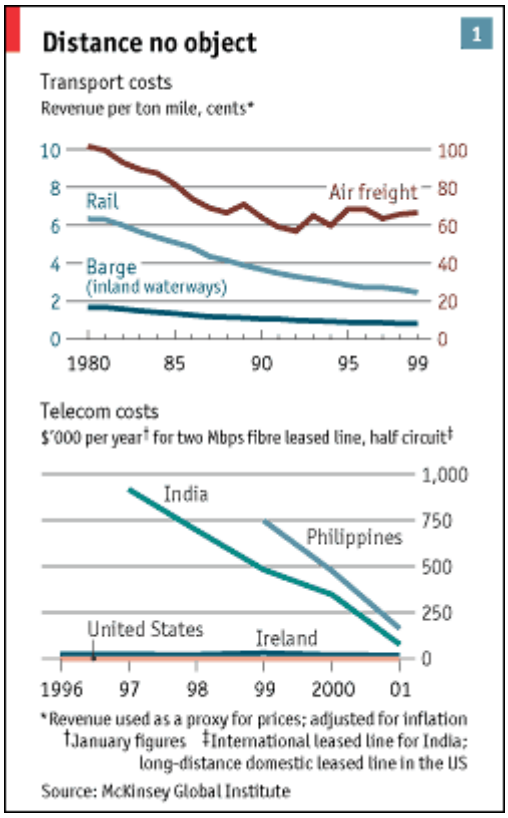
These anxieties have crystallised into a perceived threat called “outsourcing”, a shorthand for the process by which good jobs in America, Britain or Germany become much lower-paying jobs in India, China or Mexico. Politicians decry outsourcing and the bosses they blame forperpetrating it. The same media that greeted the rise of the new economy in the 1990s now mourn the jobs that supposedly migrate from rich countries to less developed ones.

Forrester, an American research firm, has estimated these future casualties down to the last poor soul. By 2015, America is expected to have lost 74,642 legal jobs to poorer countries, and Europe will have 118,712 fewer computer professionals. As Amar Bhide of Columbia University comments drily, “Graphs

from a few years ago that used to predict explosive growth in e-commerce have apparently been re-labelled to show hyperbolic increases in the migration of professional jobs."

Amid all this clamour, some of the vocabulary has become mixed up. Properly speaking, outsourcing means that companies hand work they used to perform in-house to outside firms. For example, Brillian is outsourcing the manufacture of its televisions to Flextronics or Solectron. Where that work should be done involves a separate decision. Flextronics might assemble bits of its televisions in Asia but put together the final products close to its customers in America. If it does, it will have moved part of its manufacturing "offshore". Not all offshore production is outsourced, however: Brillian might one day open its own "captive" research-and-development facility in Bangalore, for instance.

What agitates worriers in the West is the movement of work abroad, regardless of whether it is then outsourced or performed in-house. But the reality is more complicated than they acknowledge.



A well-established model

The age of mass mechanisation began with the rise of large, integrated assembly lines, such as the one Henry Ford built in 1913 at Dearborn, Michigan, to make the Model T. Over the course of the 20th century, companies reorganised industrial production into ever more intricate layers of designers, subcontractors, assemblers and logistics specialists, but by and large companies have mostly continued to manufacture close to where their goods are consumed. They have then grown internationally by producing overseas, for new customers, the same goods they produce and sell to their customers at home: 87% of foreign direct investment is made in search of local markets, according to McKinsey, a consultancy. Products and brands have become global, but production has not.

Conversely, white-collar work continues to be produced in the same way that Ford produced the Model T: at home and in-house. Bruce Harreld, the head of strategy at IBM, reckons that the world's companies between them spend about $19 trillion each year on sales, general and administrative expenses. Only $1.4 trillion-worth of this, says Mr Harreld, has been outsourced to other firms.

Brillian obtains both the goods and the services it needs to put together its televisions from outsiders all over the world, which means each bit of work goes to whatever company or country is best suited to it. This opens up huge opportunities. Diana Farrell, the head of McKinsey's Global Institute, thinks that by reorganising production intelligently, a multinational firm can hope to lower its costs by as much as 50-70%.

Such reorganisation takes two main forms. First, thanks to the spread of the internet, along with cheap and abundant telecommunications bandwidth, businesses are able to hand over more white-collar work to specialist outside suppliers, in the same way as manufacturers are doing already. A growing number of specialists offer, say, corporate human-resources services, credit-card processing, debt collection or information-technology work.

Second, as transport costs fall, globalisation is beginning to separate the geography of production and consumption, with firms producing goods and services in one country and shipping them to their customers in another. Over the past ten years, countries such as Mexico, Brazil, the Czech Republic and, most notably, China have emerged as important manufacturing hubs for televisions, cars, computers and other goods which are then consumed in America, Japan and Europe. Such offshore production is central to the strategies of some of the world's most powerful businesses, including Wal-Mart and Dell.

Over the next ten years, Russia, China and particularly India will emerge as important hubs for producing services such as software engineering, insurance underwriting and market research. These services will be consumed at the other end of a fibre-optic cable in America, Japan and Europe. Just as Dell and Wal-Mart are obtaining manufactured goods from low-cost countries, companies such as Wipro, TCS and

Infosys, for instance, are already providing IT services from low-cost India.

As businesses take advantage of declining shipping costs, abundant and cheap telecommunications bandwidth and the open standards of the internet, the reorganisation of work in each of these areas is likely to advance rapidly. IBM's figures suggest that companies have so far outsourced less than 8% of their administrative office work. Privately, some big companies say that they could outsource half or more of all the work they currently do in-house.

Rich-country manufacturers have already invested hundreds of billions of dollars in building factories in China to make clothes, toys, computers and consumer goods. In the next few years, they may invest hundreds of billions more to shift the production of cars, chemicals, plastics, medical equipment and industrial goods. Yet the globalisation of white-collar work has only just begun.

A forthcoming study by McKinsey looks at possible shifts in global employment patterns in various service industries, including software engineering, banking and IT services. Between them, these three industries employ more than 20m workers worldwide. The supply of IT services is the most global. Already, 16% of all the work done by the world's IT-services industry is carried out remotely, away from where these services are consumed, says McKinsey. In the software industry the proportion is 6%. The supply of banking services is the least global, with less than 1% delivered remotely.

McKinsey reckons that in each of these industries, perhaps as much as half of the work could be moved abroad. But even a much smaller volume would represent a huge shift in the way that work in these industries is organised. There may be just as much potential in insurance, market research, legal services and other industries.

Outsourcing inspires more fear about jobs than hope about growth. But the agents of change are the same as those that brought about the 1990s boom. New-economy communications and computer technologies are combining with globalisation to bring down costs, lift profits and boost growth. This survey will try to restore some of the hope.

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Men and machines

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Technology and economics have already revolutionised manufacturing. White-collar work will be next

THE industrial complex that Henry Ford built on the banks of the Rouge River in Dearborn, Michigan, was a wonder of the new age of mass production. Into one end of the plant went iron ore, coal, sand and rubber, brought in by railway and on Great Lakes steamships. Out of the other end rolled Model T Fords. By 1927, there had been 15m of them. At that stage, Dearborn was handling every step of the car's production, from rolling steel to making springs, axles and car bodies, and casting engine blocks and cylinder heads. The plant even had its own glass factory.

Ford built the Dearborn plant around the labour-saving properties of machines. Automation lowers production costs, which bolsters profits. Companies spend these profits on improving what they sell, and on building more labour-saving machines. As technology advances, these improvements make products more complex. To the basic design, modern car makers add heated seats, air conditioning, guidance and entertainment systems, computer chips that regulate engine performance, and many other gadgets to please their customers. It took 700 parts to make the Model T. Modern cars pack many more into their radios alone.

As industries advance, manufacturers manage the growing complexity of their products by outsourcing: they share the work of making them with others. This enables each company in the production chain to specialise in part of the complicated task. The car industry, for instance, relies on parts companies that make nothing but electrical systems, brakes or transmissions. These parts companies, in turn, depend on the work of other suppliers to make individual components. At each level of production, outsourcing divides up growing complexity into more manageable pieces.

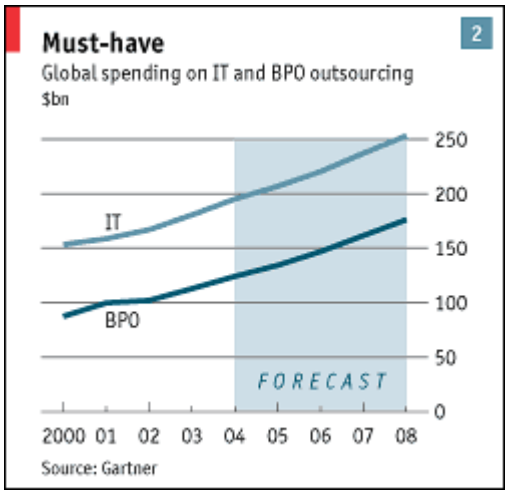
In the office, the tool used to mechanise work is the computer. Computers automate paperwork and hence the flow of information. Companies that sell information products, such as banks and insurance firms, employ computers to automate production. And all companies use computers to automate the administrative work needed to maintain their organisations: keeping their books in good order, complying with rules and regulations, recruiting, training and looking after their employees, managing offices, dealing with company travel and so on.

Bells and whistles

Like assembly-line machinery, computers save labour, bring down costs and raise profits. Banks and insurance companies have used some of these profits to add bells and whistles to their products, making them more complex. Banks that used to provide basic mortgages now sell fixed loans and floaters, caps, collars, locks and other financial exotica to befuddled home-buyers. Credit-card companies offer loyalty programmes, membership rewards and cash-back deals. Insurance firms tailor car and life insurance to fit their customers' appetite for risk.

Corporate administrative work has also become more complicated. The demands of securities regulators and investors for financial information have expanded with the capacity of firms to supply it. IBM's annual report for 1964 contains a scant half-dozen pages of financial information; its most recent one includes 40 pages of financial statements and accounting notes. The more services that corporate HR departments provide to employees, the more employees expect. Ever-more prescriptive accounting and audit rules proliferate as fast as accounting departments can automate the work of complying with them.

The spread of computers through companies has added a third layer of complexity: the task of managing the information systems themselves. The work of company IT departments is particularly complicated at older and larger firms that have bought different sorts of computer systems at different times. The core processing systems of insurance companies, airlines and banks, for instance, are built on a mainframe-computer technology that celebrated its 40th anniversary this year. Companies have added extra systems as they have sold new products, grown abroad or acquired competitors. Most IT departments at most large companies spend most of their time simply fighting to keep this tangle of systems going.



In all three areas of white-collar work, companies are struggling to manage growing complexity. The chief reason for the recent recession in corporate IT spending is that the IT industry's customers are no longer able to absorb new technologies, thinks IBM's Mr Harreld. Entangled in new products and the computer systems that support them, banks cannot even do something as basic as ensuring that customers who asked one department not to send junk mail do not receive it from another. “If a bank was making cars, every tenth car would come out without a steering wheel,” says Myles Wright of Booz Allen Hamilton, a consultancy.

Just as in manufacturing, the solution to the growing complexity of white-collar work is to do less of it in-house. Some companies have outsourced the work of their IT departments, from managing the physical hardware to maintaining and developing business software and managing corporate computer networks. Up to half the world's biggest companies have outsourced some IT work, reckons IBM.

As well as outsourcing their business systems, some companies are doing the same with the workers who operate them. This is called business-process outsourcing (BPO). First Data Corporation (FDC), for instance, will handle some or all of the administrative work involved in running a credit-card business, from dealing with applications to authorising credit limits, processing transactions, issuing cards and providing customer service. Few bank customers will have heard of the company, yet FDC employs nearly 30,000 people, who administer 417m credit-card accounts for 1,400 card issuers.

Likewise, companies are outsourcing chunks of administrative work and their supporting systems. Accounting departments are farming out tasks such as processing invoices and collecting payments from debtors. HR departments have shed payroll work. ADP, a payroll-outsourcing company, pays one in six private-sector workers in America. Increasingly, big companies are handing over entire HR departments and the systems that support them to outside specialists such as Hewitt, Accenture and Convergys, says Duncan Harwood of PricewaterhouseCoopers.

One way for manufacturers to manage growing complexity is to adopt common standards. Carmakers, for instance, have reworked their manufacturing processes so they can assemble different car models from the same production “platform”, with several cars sharing a number of parts. This allows parts companies to specialise more and produce fewer parts in larger numbers.

Eventually the organisation of car manufacturing may begin to resemble production in the consumer-electronics industry, where the adoption of industry-wide standards (along with de facto standards, such as the Intel microprocessor) has enabled suppliers to become highly specialised. Companies such as Flextronics and Selectron now offer outsourced manufacturing platforms for whole categories of consumer electronics. All the branded makers have to do is handle the logistics, badge the goods and send them off to the shops.

A similar platform-production system is emerging in white-collar work. A few popular business-software packages sold by companies such as SAP, a German software firm, and PeopleSoft, an American one, are now offering standard ways of organising and delivering administrative office work. When companies

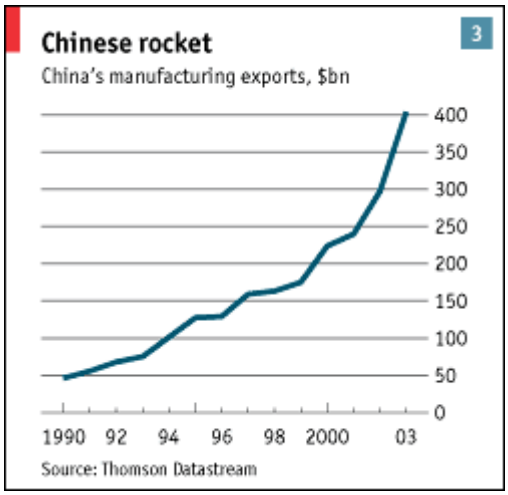
outsource HR departments, specialists such as Hewitt and Accenture add them to their HR-services production platform. Convergys, for instance, claims to be the world's largest operator of SAP's HR software. FDC, for its part, has built a production platform that offers credit-card services.

Thanks to the internet's open standards, extreme specialisation is now emerging in outsourced business services, just as it did earlier in consumer electronics. Next door to a Safeway supermarket on the Edgware Road in London, a group of British accountants and tax experts has built a business service called GlobalExpense that handles employees' expenses over the internet. Employees of its customer companies log on to the GlobalExpense website, record their expenses on standard forms and put their receipts in the mail. GlobalExpense checks the receipts, pays the expenses and throws in a few extras such as related tax work and information on whom the company's employees are wining and dining.

This year GlobalExpense will pay out £60m-worth of employee expenses, which probably makes it the biggest expense-payer in Britain. With a large, flexible pool of foreign students in London to draw on, the company says it can handle expense claims and receipts from anywhere in the world.

And so to Bangalore

In the late 1980s and early 1990s, as transport and communications costs fell and logistics technology improved, rich-country manufacturers began moving production to cheaper nearby countries. American carmakers and consumer-electronics firms started manufacturing in Mexico; European makers went to the Czech Republic, Slovakia and Poland; and Japanese, Taiwanese and Korean firms moved to China. By the late 1990s, European manufacturers such as Philips, Siemens and Nokia, and American ones such as GE and Motorola, were moving further afield, to China. American imports from China rose from $66 billion in 1997 to $163 billion last year. By one estimate, foreign companies opened 60,000 factories in China between 2000 and 2003. The country's exports rocketed (see chart 3).



In the same way, with the cost of telecommunications bandwidth falling, some firms in rich countries, mostly in America and Britain, began moving some of their business services abroad, so far mostly to India. IT-service companies such as IBM, EDS and Accenture have hired thousands of Indian software engineers to carry out work previously done near their customers in rich countries. An Indian GE subsidiary called GECIS handles administrative processing work for the firm's financial businesses. NASSCOM, the Indian IT-industry lobby, has high hopes for these young export industries. By 2008, it thinks, they will employ over 4m Indians, generating up to $80 billion-worth of sales.

Firms may choose to outsource work when they move it abroad, and they may not. But actually moving particular operations abroad is more akin to introducing labour-saving machinery than to outsourcing in the sense of improving the management of complexity. It brings down the cost of production, mostly by making use of cheaper employees.

Sometimes companies even change their technology when they move abroad, making their production less automated so they capture more benefits from lower labour costs. For example, some big carmakers are reconfiguring their production to use more manual work in their Chinese factories than they do elsewhere, says Hal Sirkin of the Boston Consulting Group. Wipro Spectramind, an Indian firm, recently moved work for an American company to India. This work involved 100 people, each of whom cost the firm $6,000 in software-licence fees. The American company had been trying to write software to automate some of this work and reduce its licence-fee payments. Wipro scrapped the software project, hired 110 Indians and still did the work more cheaply.

Once work has moved abroad, however, it joins the same cycle of automation and innovation that pushes technology forward everywhere. Optical-character-recognition software is automating the work of Indian data-entry workers. Electronic airline tickets are eliminating some of the ticket-reconciliation work airlines carry out in India. Eventually, natural-language speech recognition is likely to automate some of the call-centre work that is currently going to India, says Steve Rolls, the heir apparent at Convergys, the world's largest call-centre operator.

All this helps to promote outsourcing and the building of production platforms in India. GE is selling GECIS, its Indian financial-services administrator, and Citibank, Deutsche Bank and others have disposed of some of their Indian IT operations. Thanks to the growth of these newly independent firms, along with the rapid development of domestic Indian competitors, such as Wipro and Infosys, companies will increasingly be able to outsource work when they move it.

Dashing white collars

Manufacturing has already gone a long way down the road of outsourcing and globalisation, but there are now fears that white-collar work will be reorganised much more quickly and disruptively, thanks to the spread of the internet, plummeting telecommunications costs and the realisation that the machines used by millions of expensive white-collar workers in the West could be plugged in anywhere.

Manufacturers' shipping costs have declined more slowly than the telecommunications costs of providers of remote services. The logistics of shipping goods over long distances remain complicated and inexact. For example, the V6 car engines that Toyota sends from Nagoya in Japan to Chicago take anywhere between 25 and 37 days to arrive, forcing the car company to hold costly stocks. The movement of white-collar work, on the other hand, is subject to no physical constraints. Communications are instant and their cost is declining rapidly towards becoming free.

Yet powerful barriers to moving white-collar work remain. When work moves out of a company, the firm negotiates a commercial agreement to buy it from a supplier. For manufacturers, this is straightforward: they take delivery, inspect the goods and pay their suppliers. Supplying a service, by contrast, is a continuous process. The outsourcing industry has evolved legal contracts in which suppliers bind themselves to deliver promised levels of service. There has been much legal innovation around these contracts, not all of which has been satisfactory (see article). The upshot is that it still takes trust and cross-cultural understanding to achieve a good working relationship. Moving a company's IT department to India is likely to put such understanding to the test.

The other big barrier is that, despite the spread of business machines, white-collar work still tends to be much less structured and rule-bound than work done on the shop floor. Unstructured work is hard to perform over long distances: without guidance, workers are apt to lose their way. The most likely outcome is that would-be outsourcers will proceed in two steps. First they will hand IT services, administrative tasks and other white-collar work to trusted specialist suppliers close to home. But once those suppliers have added structure, rules and standards, the outsourcers will move the work abroad.

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A desperate embrace

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From The Economist print edition

Companies do not always outsource for the best of reasons

IN 2001 and 2002, KPN, a Dutch telecoms carrier, signed several long-term deals to outsource 80% of the work done by its IT department to Atos Origin, a European provider of IT services. Three years later, both parties are still putting a lot of effort into reworking these contracts. It shows that not all decisions to outsource are straightforward and problem-free.

In 2001, KPN, like most telecoms firms, was in desperate trouble: having run up huge debts as it expanded during the telecoms bubble, it was close to bankruptcy. Atos Origin said it could help, and not just with the IT. In return for a guarantee from KPN to buy about *euro*300m-worth of IT from it every year for the next six years, Atos Origin paid KPN *euro*206m up front for the IT assets that the telecoms firm had handed over.

But as the spread of mobile phones and digital fixed-line technology ate into KPN's sales, the firm had to make drastic cuts. Within two years its headcount had shrunk from 28,000 to 18,000. It was now less than two-thirds its size when it signed its IT deal, yet it was still bound by contract to buy the same *euro*300m-worth of IT services a year.

Both parties admit that relations over the past year have not been easy. Neither party, however, can easily walk away. The solution they are groping towards is that in the next two years Atos Origin will work to transform KPN's IT systems. KPN's fixed-line division, for instance, runs 779 different applications, which the company itself thinks it can shrink to 80. That should keep its IT purchases up for a while, and so avoid any immediate damage to Atos Origin's revenues. After that, hopes Atos Origin, it will have earned the right to more transformation work from its customer, thus maintaining the value of its original contract.

Whether such “transformational” agreements are the best way forward is the subject of much debate in the industry. Supporters argue that they help to align the interests of outsourcing firms with those of their customers. Critics say they are a way of landing the industry's customers with the risk that something may go wrong: the criteria for a successful transformation are sufficiently nebulous for clever lawyers to claim that they have been met, whatever the outcome.

The larger issue, however, is the way IT firms sell financial engineering along with their systems and software. Governments, for instance, are avid advocates of long-term contracts because they can spread the cost of a large IT investment over many years, making it look more manageable. So long as the industry continues to offer this sort of balance-sheet support along with the technological variety, its customers may sometimes be tempted to make the wrong decision.

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The place to be

Nov 11th 2004
From The Economist print edition

In the global market for white-collar work, India rules supreme. But others are lining up

MOST Americans or Britons would be hard pressed to name their national call-centre champions or top providers of IT services. In India they are like rock stars, endlessly featured in the media. All of them claim to be hiring by the thousands every month. New business models come and go. Hero bosses such as Raman Roy, chief executive of Wipro Spectramind and “father of Indian business-process outsourcing” (an industry all of six years old), have developed the same preposterous swagger adopted by erstwhile leaders of America's dotcom boom. Is India heading for a fall, too?

India's IT industry is growing at a vertiginous rate. A dozen years ago, the entire country boasted just four or five IBM mainframe computers, says Lakshmi Narayanan, the boss of Cognizant, a big Indian IT-service company. Last year the industry notched up sales of $16 billion, three-quarters of which went abroad, according to NASSCOM, the lobby group. By 2008, says NASSCOM, annual sales are likely to surpass $50 billion. The big firms are hiring about 1,000 graduates a month straight from Indian technical colleges.

The sales of Infosys alone, one of the top providers of IT services, have grown more than eightfold in five years, to over $1 billion in the year ending in March 2004. The firm claims to run the biggest corporate training facility in the world, with 4,000 students at a time and three courses a year. The company's chairman, Narayana Murthy, says Infosys is going to expand further.

India's BPO industry is younger and smaller, but growing even faster. Last year its sales were $3.6 billion; by 2008 they are expected to reach $21 billion-24 billion, says NASSCOM. About 70% of the BPO industry's revenue comes from call-centres; 20% from high-volume, low-value data work, such as transcribing health-insurance claims; and the remaining 10% from higher-value information work, such as dealing with insurance claims. But the BPO industry is more fragmented than the IT business, and could change shape rapidly.

The roots of India's competitiveness in IT reach back to the late 1980s, when American firms such as Texas Instruments and Motorola came to Bangalore for the local talent. Other American firms, such as Hewlett-Packard, American Express, Citibank and Dun & Bradstreet, followed these pioneers, setting up their own “captive” Indian IT organisations in the 1990s.

The Indian companies got their first big boost with the so-called “Y2K crisis” at the turn of the

millennium. IT experts feared that because elderly software code allowed only two digits to record the year, some computer systems would read the year 2000 as 1900, causing mayhem as systems crashed. Big western IT-services companies such as IBM, Accenture and EDS ran out of engineers to check old code and subcontracted some of the work to Indian firms instead.

Once the Indians had saved the world, they set out to conquer it. Wipro, TCS, Infosys and their peers grabbed a growing share of the global giants' business. They made most inroads in the routine but costly business of maintaining business-software applications from vendors such as PeopleSoft and SAP.

As the Indian firms grew, the captive operations of foreign firms became less competitive, and most of them have now sold out. Dun & Bradstreet led the field, with its captive transforming itself into Cognizant in 1994. More recently, Citibank sold some of its Indian IT operation to an Indian financial-software specialist called Polaris. Deutsche Bank sold its captive to HCL, another Indian firm. The big western IT specialists, meanwhile, have squared up to the new, low-cost competition by hiring in India themselves. Accenture's Indian payroll has shot up from 150 in 2001 to about 10,000 now.

India's BPO industry also started with foreign captives. The pioneers were GE, American Express and British Airways, who all arrived in the late 1990s. These companies were joined by home-grown call-centre operators such as 24x7, vCustomer, Spectramind and Daksh. Spectramind has since been bought by Wipro, and Daksh by IBM.

Sustainable? 4

IT and BPO employment in India, '000

	2002	2003	2006*	2009*	2012*
IT	106	160	379	1,004	2,717
BPO	170	205	285	479	972

Source: NASSCOM *Forecast

These Indian firms also face competition from specialist American call-centre companies which, like the global IT firms, have been adjusting to the cheap Indian competition by taking themselves to India. By far the most successful of these foreign firms has been America's Convergys, which with a total of around 60,000 employees is the biggest call-centre operator in the world. By the end of next year, says the company's local boss, Jaswinder Ghumman, Convergys hopes to employ 20,000 people in India. Recently a fourth wave of BPO start-ups, many of them funded by American venture capitalists, has been experimenting with the remote delivery from India of all sorts of work, from hedge-fund administration to pre-press digital publishing.

In both the IT and the BPO industries, the leading companies in India are fighting hard to win a broader variety of work, particularly higher-value activities. EXL Service carries out a broad range of insurance work for British and American firms, from finding customers to underwriting policies, administering claims, changing policies and providing customer services. The company is a licensed insurance underwriter in 45 American states, with applications for the remaining states pending. “These are very high-end jobs,” says EXL Service's boss, Vikram Talwar.

The fancy stuff

In September, ICICI OneSource, an Indian BPO company which has so far concentrated on call-centre work, took a 51% stake in Pipal Research, a firm set up by former McKinsey employees to provide research services for consultants, investment bankers and company strategy departments. Mr Roy of Wipro Spectramind says that his firm is moving from basic call-centre work—helping people with forgotten passwords, for instance—to better-quality work in telesales, telemarketing and technical support. Wipro Spectramind is also spreading into accounting, insurance, procurement and product liability. “We take the raw material and convert it,” says Mr Roy, his eyes gleaming. “That is our skill—to cut and polish the raw diamonds.”

The top end of the market is more interesting still. Viteos, an Indian start-up, pays new MBA graduates in Bangalore $10,000 a year to administer American hedge funds, work that involves reconciling trades and valuing investments for a demanding set of customers. Shailen Gupta, who runs an offshore advisory consultancy called Renodis, has been helping one of his American customers to hire Indian PhDs to model demand planning.

The best Indian IT and BPO companies are aiming not only to lower the cost of western white-collar work, from software programming to insurance underwriting, but to improve its quality as well. Firms such as Wipro, EXL Service and WNS, a former British Airways BPO captive that won its independence in 2002, are applying the same management disciplines to the way they provide services that GE applies to its industrial businesses. Tasks are broken into modules, examined and reworked to reduce errors,

improve consistency and speed things up.

In both industries, the influence in India of GE, which has applied the “six sigma” method of quality improvements to its industrial businesses for years, is pervasive. Mr Roy of Wipro Spectramind used to run GECIS, which was then GE's BPO captive but is now being sold. It had become “too fat and happy”, according to one Indian competitor. One of the founding investors in Mr Talwar's company is Gary Wendt, the former head of GE's financial businesses. Wipro's chairman, Azim Premji, has introduced so many of GE's techniques to his company that the firm is known as India's “baby GE”.

Certainly, “Wiproites” seem to share the intensity of GE's employees. Six-sigma “black belts” hurtle about Wipro's 100-acre technology campus in Bangalore, improving everything from software coding to the way the company cleans its toilets. (Among other things, this involves analysing liquid-soap availability, tissue supply and waste management, explains a serious-looking Wipro official.)

The claims of India's marketing men tend to be a little ahead of reality. Amar Bhide of Columbia University, who has spent most of the past 18 months in Bangalore, is sceptical. The Y2K crisis pushed “the grungiest IT work on to India's best software engineers,” says Mr Bhide. “It was like asking Oxford graduates to dig ditches. It created the impression that Indians were fantastic at programming.”

Still, the outline of a distinct brand of Indian competitiveness—in performing carefully defined, rules-bound, repetitive white-collar business work—appears to be taking shape. Already, the Indian IT firms, along with some of the foreign captives in India, boast the world's most impressive set of international quality certifications for software engineering.

In the longer term, India's success at winning global white-collar work will depend on two things: the supply of high-quality technical and business graduates; and, more distantly, an improvement in India's awful infrastructure.

India's most often-cited advantage is its large English-speaking population, which has helped to fuel the call-centre boom. Yet already the market for call-centre workers is tightening. Pay and staff turnover are shooting up as operators poach staff who have already undergone costly “accent neutralisation” training at rival firms. Even the best call-centre operators in India lose about half their employees each year (but then turnover in British call-centres is about 70%). One Convergys job advertisement in the *Times of India* promises to make prospective call-centre employees “a prime target of all the dons of the industry. You will be hunted down, with almost a king's ransom on your head.”

No dream job

Part of the problem is that call-centre work tends not to be much fun—although Indians enjoy much better pay, relative to other local jobs, than British or American call-centre employees. At Wipro Spectramind, two “fun day” employees try to jolly the place up as rows of cubicle-farm workers use a piece of software called “retention buddy 1.3” to dissuade Americans from cancelling their internet subscriptions. Sanjay Kumar, the boss of vCustomer, one of the few remaining independent Indian call-centre companies, says the industry's growth potential may be limited. He thinks the total pool of call-centre workers is only about 2m, and awkwardly scattered across India—although that still leaves a lot of room for expansion from the current 300,000 or so.

According to official figures, India produces about 300,000 IT engineering graduates every year, against America's 50,000. But the quality is mixed. The best Indian IT firms fight over the top 30,000-40,000 graduates, a pool in which foreign companies such as IBM and Accenture also fish. Wage inflation at Wipro and Infosys is running at 15-17% a year, and is likely to worsen. Assuming a supply of 40,000 decent IT engineers a year, McKinsey's Diana Farrell thinks that India will “not even come close” to meeting the demand for 1m offshore IT and software workers her company forecasts for 2008.

The supply of top-quality Indian MBAs is also thinner than it might look at first sight. Indian business schools produce about 90,000 graduates a year, but everybody fights over the top 5,000 from the six state-run Indian Institutes of Management. “I'm afraid to say that for some of the private business schools it is two classrooms, 25 desktops, four faculty members, 600 books and you're away,” sniffs one state-sector professor.

The biggest supply may be of BPO workers who do not need to use the telephone much: claims processors, credit-card administrators, health-insurance workers and so on. Indian universities churn out

2.5m graduates a year. Perhaps a quarter to half of these have the right skills to do this sort of BPO work, says NASSCOM's president, Kiran Karnik. To improve that ratio, he is working with India's University Grants Commission to have three-year degree courses supplemented by one-year technical certificates in IT or American accounting standards.

Mr Karnik thinks that the market itself will exact higher standards. The inferior private technical institutes and management schools that have sprung up since the government deregulated higher education in the 1990s charge about three times the fees of the elite state institutions, says Mr Karnik. No doubt the private schools will try to do better, but it will take time. Meanwhile, growing demand for offshore IT and call-centre workers is already directing companies to other parts of the world.

Where to look next

The call-centre business in the Philippines is booming. China is attracting a healthy share of manufacturing-related R&D work: GE, Siemens and Nokia all do research there. Although China's IT industry is patchy and much less well organised than India's, this is likely to change in the next five years: China already churns out more IT engineers than India. Atos Origin, a big European IT-services firm, says it is more interested in China than in India because there is less competition for engineers.

The IT industry in eastern Europe and Russia is also scattered and poorly organised, but the talent is there if you look for it, says Arkadiy Dobkin. He is the head of Epam, an IT firm that claims to be the largest provider of offshore IT services in that part of the world, with over 1,000 engineers in Budapest, St Petersburg, Minsk and Moscow. “The engineers that Russia produces are comparable to India's,” says Mr Dobkin. “The educational machine is still working.” He reckons that a Russian or Hungarian IT engineer costs “about the same, or a little bit more” than an Indian engineer. American multinationals are already scouring the region for talent.

For the moment, India accounts for about 80% of the low-cost offshore market, and is probably exerting a stronger pull than ever. In the long run, however, it is sure to face hotter competition, especially from China and Russia. When it does, the abysmal quality of its infrastructure will become crucial. The most important thing to improve is India's airports, says Mr Murthy of Infosys: “The moment of truth comes when foreigners land in India. They need to feel comfortable.” After airports, Mr Murthy lists better hotels, roads, schools and power supply, in that order.

The headquarters of Infosys in Bangalore sit on 70 acres of pristine lawns and paths. The facilities include open-air restaurants, an amphitheatre, basketball courts, a swimming pool and even a one-hole golf course. “When we created this campus, we wanted everything to work as well as it does in America, to be as clean as America is,” says Mr Murthy. But outside the perimeter walls, the place remains unmistakably India.

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Faster, cheaper, better

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India's emerging IT firms are trying to beat their western rivals on their home turf

CAN India's IT industry do to the West's IT giants what Wal-Mart has done to rival retail firms, or Dell to computer makers? The Indians talk a good game. “The productivity growth of Indian IT services is the highest in the world,” says Mr Narayanan at Cognizant. He should know: one-third of his firm's employees are in America and two-thirds in India. Nandan Nilekani, the chief executive of Infosys, goes further. “Almost everything that is done can be done by us faster, cheaper and better,” he says.

The argument for an Indian takeover of the world goes something like this. Like Dell and Wal-Mart, companies such as Infosys, TCS, Wipro and Cognizant source their offerings from poor, cheap countries. Wal-Mart has grown by adding Chinese-made toys, clothing and household appliances. Dell has added printers, hand-held devices and televisions to its line of made-in-Asia computers. In the same way, predict the Indian firms breezily, they will grow by adding new lines of IT services, offering global standards or better but produced at Indian costs. Investors understand this, say the Indians. Accenture's revenue is 14 times that of Infosys, but the American firm's market value is only one-third higher than that of its Indian competitor.

IBM and Accenture have been recruiting in India to lower their costs in areas where the Indian firms have grown fastest, such as maintaining popular business-software packages. But these global firms are so large (IBM employs 340,000 people; Accenture 100,000) that hiring even 10,000 extra staff in India has made little difference to their overall costs, most of which are still incurred in rich, expensive economies, the Indian firms point out gleefully. “The multinationals will never be able to restructure their costs fast enough to shift their centres of gravity,” says Arindam Bhattacharya of the Boston Consulting Group in New Delhi.

Moreover, because the Indian firms know India better than their American and European rivals do, they can grow (and are indeed growing) more quickly and more cheaply in India than anyone else. This will lower their costs even further. “We're adding close to 5,000 people in India this year,” says Mr Narayanan. “No American company can do that.” However, Accenture may recently have grown far more quickly in India than it can easily manage—though it bristles at the suggestion that it is finding India unusually difficult.

Wal-Mart sells commodities, such at microwave ovens at $28. In commodity businesses, the firm with the lowest price, which is often achieved by selling at the highest volume, wins the most customers. But not everything the IT industry sells is a commodity.

Layer cake

Broadly, the industry has three layers. The bottom one consists of businesses that have clearly become commodities. These are ruled by common standards, as in IT hardware manufacturing (where high-volume, low-cost Dell operates). A lot of this has moved to Asia.

The top layer is made up of tailored, bespoke technology services. Accenture, for instance, advertises work it has done for a large Australian casino to introduce a tracking technology, called Radio Frequency Identification, to improve the way the casino handles the 80,000 bits of staff clothing it has dry-cleaned every year. IBM is working with an American limousine-fleet company to introduce the same mathematical models the airline industry uses to route aircraft. Atos Origin, the European IT-services firm, is working with a British government agency, the Vehicle and Operator Services Agency, to equip its inspectors with hand-held computers to help them decide which passing vehicles to check. Because these services are tailored to meet the needs of individual customers, they are likely to continue to be provided close to the IT industry's biggest customers in America, Europe and Japan.

That leaves a large block of services sandwiched in the middle. These services are on their way to becoming commodities as shared standards spread. The ready adoption of a small number of business-software packages sold by firms such as SAP and PeopleSoft, for instance, is making the maintenance and even the installation of such software increasingly routine as these popular packages are becoming de facto standards. It is this large middle layer of services that is currently feeding the rapid growth of Indian firms such as TCS and Infosys.

Champions of the Indian firms look at the industry's employees and see a large bulge of people offering this middle layer of IT services, with a thinner sliver of business consultants doing the bespoke work on top. This makes them think that it should be far easier for the Indian firms to move up to that top layer by hiring consultants in America and Europe than for western IT firms to shift most of their employees (and their costs) from rich countries to poor ones. “About 20% of our value is added near our customers in America and Europe and 80% here in India,” says Infosys's Mr Murthy. “If IBM wants to replicate this, it needs 80% of its employment in less developed countries as well.”

This analysis neglects several important points. Perhaps the most crucial of these is that patterns of demand in the IT industry have shifted in the past, and may well do so again. Ten years ago customers spent a much bigger chunk of their IT budgets on computer hardware than they do now. Between 1993 and 2001, calculates Catherine Mann of the Institute for International Economics, spending on software and services grew by 12.5% a year, nearly twice as fast as hardware spending, pushing the share of software and services in overall expenditure from 58% to 69%.

As Ms Mann points out, the movement of IT hardware manufacturing to low-cost Asia helped to finance this shift in demand, because falling hardware prices freed up money to spend on software and services. Likewise, thinks Ms Mann, the migration of commodity IT services to low-cost places such as India will leave companies with more money to spend on the top-end bespoke services, which will help to expand this category of work.

If the world's IT giants want to remain big, they will have to change to meet changing demand. IBM has already performed this trick once. At the beginning of the 1990s, the company was mainly a hardware manufacturer. By the end of that decade, it had shifted much of its weight into IT services. Now, says IBM's Mr Harreld, the firm needs to move its high-cost employees into tailored services as commodity services migrate offshore.

Tomorrow's giants? 5

India's top IT-services firms, 2004*

	Total revenue $bn	Market capitalisation Oct 29th, $bn	Employees '000
TCS	1.62	12.17	40.9
Wipro	1.34	10.13	32.0
Infosys	1.08	11.26	32.9
HCL Tech†	0.57	2.38	16.4
Satyam	0.57	2.62	15.6

*Financial years ending March
†Financial years ending June

Sources: Company annual reports; Thomson Datastream

The end of the beginning

Mr Harreld predicts that demand for such bespoke services will grow strongly, and that it will be many years before everything the IT industry sells becomes a commodity. To support his argument, he turns to Carlota Perez, an economic historian. In her book, “Technological Revolutions and Financial Capital”, Ms Perez traces five boom-and-bust cycles of technological innovation: the industrial revolution; steam and railways; steel, electricity and heavy engineering; oil, cars and mass production; and information technology and telecommunications.

In each age, argues Ms Perez, a phase of innovation, fuelled by hot money, has been followed by a financial bust, and then by an extended period in which the technology is deployed properly. Having just emerged from its bust, the information age is only at the beginning of this long deployment period, says Mr Harreld. Proper deployment, he argues, will require a large number of people working close to the industry's customers, in the way that IBM is doing for its limousine-fleet customer, or that Atos Origin is doing for Britain's vehicle-safety agency.

Two questions remain. The first is how long it will take for the large middle layer of services to become a commodity. If this happens too quickly, companies such as IBM, EDS and Accenture may find themselves overwhelmed by the pace of change, just as IBM nearly found itself ruined by the shift of IT manufacturing overseas in the early 1990s.

Of the three giants, EDS is in the weakest position. Having struggled with financial troubles and management turmoil at home, it has done little so far to counter the threat from Indian competitors, who are eating into large chunks of its business. Other smaller IT-services companies, such as BearingPoint and Capgemini, may also struggle with the shift of services abroad.

Most services in the middle layer, however, are likely to move offshore at a fairly manageable speed. That is because the IT organisations of most large companies tend to be a tangled mess of overlapping systems which go wrong so often that, as a practical matter, it will be hard to move IT work anywhere without fixing the systems first. To illustrate this point, Mr Harreld produces a diagram showing the different systems of one of IBM's customers, along with their interconnections. It is so intricate that it might pass for the design of a semiconductor chip. IBM itself runs 17,000 software applications, a figure that Mr Harreld thinks can comfortably shrink to 10,000 in due course.

The other big question is how easily companies such as Wipro, TCS and Infosys can expand into that upper crust of bespoke services that Mr Harreld predicts will flourish close to the industry's customers in rich countries. The Indian firms have lots of cash to spend: the cost of an Indian programmer is so much lower than an American one that Wipro and Infosys are earning fat profits on lines of business that may be only just profitable for big western companies. So far, the Indians have spent their money cautiously, making small acquisitions and hiring the odd western consultant from rival firms.

If they are serious about taking on companies such as IBM and Accenture, the Indian firms will have to act more boldly. Yet buying or building people businesses of this kind is notoriously difficult. Time and again, and in all sorts of industries, from banking to telecommunications, America's and Europe's best managers have tried and failed miserably. Moreover, the competition is well entrenched. IBM, for example, has built up good relations with its customers over decades. The Indian companies may yet find that the only thing they can do faster and better on their rivals' home turf is to lose their shirts.

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Into the unknown

Nov 11th 2004
From The Economist print edition

Where will the jobs of the future come from?

“HAS the machine in its last furious manifestation begun to eliminate workers faster than new tasks can be found for them?” wonders Stuart Chase, an American writer. “Mechanical devices are already ousting skilled clerical workers and replacing them with operators...Opportunity in the white-collar services is being steadily undermined.” The anxiety sounds thoroughly contemporary. But Mr Chase's publisher, MacMillan, “set up and electrotyped” his book, “Men and Machines”, in 1929.

The worry about “exporting” jobs that currently grips America, Germany and Japan is essentially the same as Mr Chase's worry about mechanisation 75 years ago. When companies move manufacturing plants from Japan to China, or call-centre workers from America to India, they are changing the way they produce things. This change in production technology has the same effect as automation: some workers in America, Germany and Japan lose their jobs as machines or foreign workers take over. This fans fears of rising unemployment.

What the worriers always forget is that the same changes in production technology that destroy jobs also create new ones. Because machines and foreign workers can perform the same work more cheaply, the cost of production falls. That means higher profits and lower prices, lifting demand for new goods and services. Entrepreneurs set up new businesses to meet demand for these new necessities of life, creating new jobs.

As Alan Greenspan, chairman of America's Federal Reserve Bank, has pointed out, there is always likely to be anxiety about the jobs of the future, because in the long run most of them will involve producing goods and services that have not yet been invented. William Nordhaus, an economist at Yale University, has calculated that under 30% of the goods and services consumed at the end of the 20th century were variants of the goods and services produced 100 years earlier. “We travel in vehicles that were not yet invented that are powered by fuels not yet produced, communicate through devices not yet manufactured, enjoy cool air on the hottest days, are entertained by electronic wizardry that was not dreamed of and receive medical treatments that were unheard of,” writes Mr Nordhaus. What hardy late 19th-century American pioneer would have guessed that, barely more than a century later, his country would find employment for (by the government's latest count) 139,000 psychologists, 104,000 floral designers and 51,000 manicurists and pedicurists?

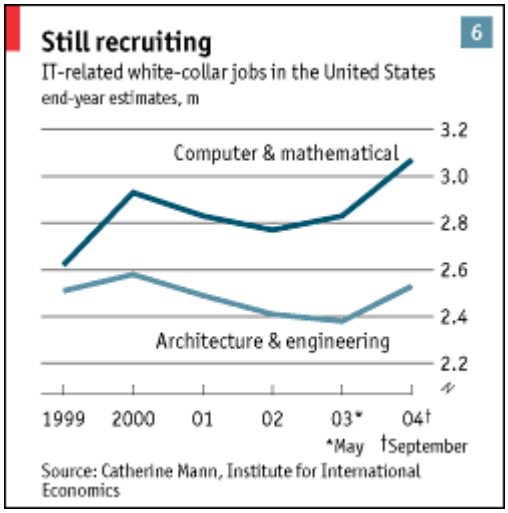
Even relatively short-term labour-market predictions can be hazardous. In 1988, government experts at the Bureau of Labour Statistics confidently predicted strong demand in America over the next 12 years

for, among others, travel agents and petrol-station attendants. But by 2000, the number of travel agents had fallen by 6% because more travellers booked online, and the number of pump attendants was down to little more than half because drivers were filling up their cars themselves. Of the 20 occupations that the government predicted would suffer the most job losses between 1988 and 2000, half actually gained jobs. Travel agents have now joined the government's list of endangered occupations for 2012. Maybe they are due for a modest revival.

You never know

The bureau's statisticians are now forecasting a large rise in the number of nurses, teachers, salespeople, “combined food preparation and serving workers, including fast food” (a fancy way of saying burger flippers), waiters, truck drivers and security guards over the next eight years. If that list fails to strike a chord with recent Stanford graduates, the bureau also expects America to create an extra 179,000 software-engineering jobs and 185,000 more places for computer-systems analysts over the same period.

Has the bureau forgotten about Bangalore? Probably not. Catherine Mann of the Institute for International Economics points out that the widely quoted number of half a million for IT jobs “lost” to India in the past couple of years takes as its starting point the year 2001, the top of the industry's cycle. Most of the subsequent job losses were due to the recession in the industry rather than to an exodus to India. Measured from 1999 to 2003, the number of IT-related white-collar jobs in America has risen (see chart 6).



Ms Mann thinks that demand will continue to grow as falling prices help to spread IT more widely through the economy, and as American companies demand more tailored software and services. Azim Premji, the boss of Wipro, is currently trying to expand his business in America. “IT professionals are in short supply in America,” says Mr Premji. “Within the next few months, we will have a labour shortage.”

If that seems surprising, it illustrates a larger confusion about jobs and work. Those who worry about the migration of white-collar work abroad like to talk about “lost jobs” or “jobs at risk”. Ashok Bardhan, an economist at the University of California at Berkeley, thinks that 14m Americans, a whopping 11% of the workforce, are in jobs “at risk to outsourcing”. The list includes computer operators, computer professionals, paralegals and legal assistants. But what Mr Bardhan is really saying is that some of this work can now also be done elsewhere.

What effect this has on jobs and pay will depend on supply and demand in the labour market and on the opportunity, willingness and ability of workers to retrain. American computer professionals, for instance, have been finding recently that certain skills, such as maintaining standard business-software packages, are no longer in such demand in America, because there are plenty of Indian programmers willing to do this work more cheaply. On the other hand, IT firms in America face a shortage of skills in areas such as tailored business software and services. There is a limited supply of fresh IT graduates to recruit and train in America, so companies such as IBM and Accenture are having to retrain their employees in these sought-after skills.

Moreover, Mr Bardhan's list of 14m jobs at risk features many that face automation anyway, regardless of whether the work is first shipped abroad. Medical transcriptionists, data-entry clerks and a large category of 8.6m miscellaneous “office support” workers may face the chop as companies find new ways of mechanising paperwork and capturing information.

Indeed, the definition of the sort of work that Indian outsourcing firms are good at doing remotely—repetitive and bound tightly by rules—sounds just like the sort of work that could also be delegated to machines. If offshoring is to be blamed for this “lost” work, then mechanical diggers should be blamed for usurping the work of men with shovels. In reality, shedding such lower-value tasks enables economies to redeploy the workers concerned to jobs that create more value.

Stuart Chase understood the virtuous economics of technological change, but he still could not stop

himself from fretting. “An uneasy suspicion has gathered that the saturation point has at last been reached,” he reflected darkly. Could it be that, with the invention of the automobile, central heating, the phonograph and the electric refrigerator, entrepreneurs had at long last emptied the reservoir of human desires? He need not have worried. Today's list of human desires includes instant messaging, online role-playing games and internet dating services, all unknown in the 1920s. And there will be many more tomorrow.

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Sink or Schwinn

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Sourcing from low-cost countries works only in open and flexible labour markets. Europe's are neither

WHEN Hal Sirkin was growing up in 1960s America, the bicycle that every regular American child wanted was a Schwinn. In 1993, Schwinn filed for bankruptcy. The firm had been overtaken by imported Chinese bicycles. In 2001, a company called Pacific Cycle bought the Schwinn brand out of bankruptcy. Pacific Cycle, now owned by a Canadian consumer-goods firm called Dorel Industries, says the secret of its success is “combining its powerful brand portfolio with low-cost Far East sourcing.” Schwinn bicycles now line the aisles at Wal-Mart.

Mr Sirkin is a consultant with the Boston Consulting Group who helps his customers do what Pacific Cycle has done to Schwinn: move production to East Asia, especially to China. Wal-Mart buys $15 billion-worth of Chinese-made goods every year. Obtaining goods and services from low-cost countries helps to build strong, growing companies, such as Dorel Industries, and healthy economies. But the Schwinn story also contains the opposite lesson: failing to buy in this way can seriously damage a company's health.

Sourcing from low-cost countries brings many economic benefits. Cheaper labour brings down production costs. This keeps companies competitive, raises profits and reduces prices as firms pass their lower costs on to their customers. Higher profits and lower prices lift demand and keep inflation in check. Companies spend their profits on improving existing products or introducing new ones. Customers buy more of the things they already consume, or spend the money on new goods and services. This stimulates innovation and creates new jobs to replace those that have gone abroad.

Moving work abroad may also help to speed up innovation directly, as American, European and Japanese companies get some of their R&D done by Chinese, Russian or Indian engineers. Randy Battat, the boss of Airvana, a telecoms-equipment start-up, has spent the past 18 months setting up an R&D centre for his company in Bangalore. This will complement the work of Mr Battat's engineers in Chelmsford, Massachusetts. The ones working in America will develop the next generation of the company's technology. The Bangalore centre will elaborate Airvana's existing technology. “They are adding bells and whistles that could not be added otherwise because it would not be cost-effective,” says Mr Battat.

By making IT more affordable, sourcing from cheaper countries also spreads the productivity-enhancing effects of such technology more widely through the economy. Ms Mann of the Institute for International Economics calculates that globalised production and international trade has made IT hardware 10-30%

cheaper than it would otherwise have been. She reckons that this price reduction created a cumulative $230 billion-worth of additional GDP in America between 1995 and 2002 as more widespread adoption of IT raised productivity growth. Sourcing IT services (which account for 70% of overall corporate spending on IT) from countries such as India will create a “second wave of productivity growth”, predicts Ms Mann, as cheaper IT spreads to parts of the economy that have so far bought less of it, such as the health-care industry and smaller companies.

McKinsey calculates that for every dollar American firms spend on service work from India, the American economy receives $1.14 in return. This calculation depends in large part on the ability of America's economy to create new jobs for displaced workers. America's labour market is a miracle of flexibility: it creates and destroys nearly 30m jobs a year.

However, in countries such as Germany, France and Japan a combination of social legislation, stronger trade unions, regulations and corporate-governance arrangements make employment practices more rigid and sometimes keep wages higher than they would otherwise be. This reduces demand for labour and pushes unemployment higher. According to McKinsey, in Germany, the re-employment rate for IT and service workers displaced by sourcing from low-cost countries may be only 40%. As unemployment at home rises, that process could actually make Germans poorer (see chart 7).

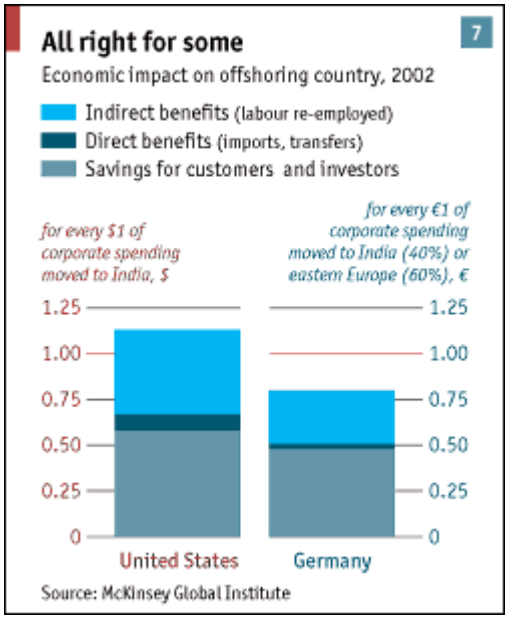
Reluctant Europeans

Udo Jung of the Boston Consulting Group says that, by and large, Germans accept that manufacturing companies such as Hella, Bosch and Siemens must get supplies from China. Degussa, a chemicals manufacturer, recently invited its workers' council on a trip to China. The idea was to take emotion out of the debate, says Mr Jung. Nor do continental Europeans seem bothered about white-collar work being done in low-cost countries. But that may be because they are doing so little of it.

At present, perhaps 80-90% of the service work being done remotely in India comes from either America or Britain, with which the country has linguistic and cultural links. Such links are absent from its relationship with Germany or France. Germany, like America, introduced a special visa programme for Indian IT workers in the 1990s as its domestic supply of engineers ran dry. But most Indians that went to work in Germany failed to learn the language and came back again, says Infosys's Mr Murthy. The opposite is true of Indians in America. Those who have gone there to work or study are often reluctant to return home to their families.

Cultural ties appear to be important in forming business relationships in remote-service work, says Rajendra Bandri of the Indian Institute of Management in Bangalore. Mr Bandri has studied five examples of European firms outsourcing white-collar work to Sri Lanka. In each case, they chose that country because a well-placed Sri Lankan worked for the European firm, says Mr Bandri.

Eastern Europe and Russia, which brim over with skilled, underemployed engineers, present fewer cultural barriers for European companies. French is spoken in Russia, German in Hungary and elsewhere. Yet neither German nor French firms have yet shown much appetite for buying services work from their neighbours, either. Arkadiy Dobkin, the boss of Epam, which claims to be the largest supplier of IT services from eastern Europe and Russia, is based in Princeton, New Jersey, rather than in Paris or Berlin.



Beyond economics

A survey of 500 European firms last summer by IDC, a research firm, found that only 11% of its sample were sourcing IT work from low-cost countries, and that nearly 80% would not even consider doing so. Attitudes were hardest in Italy, where 90% of firms were against the idea, followed by France and Germany. An American study released at the same time by Edward Perlin Associates, a consulting firm, found that around 60% of the companies it surveyed had some of their IT work done in low-cost countries.

In continental Europe, companies may outsource for reasons that have little to do with favourable economics, says Francis Delacourt, the head of outsourcing at Atos Origin. In what he describes as “social outsourcing”, firms such as Atos Origin may take on surplus IT employees from companies that no longer need them. Europe-wide social legislation requires the new employer to provide the same wages and benefits as the old one. The alternative is costly redundancy. Mr Delacourt says this works for his company, up to a point, because demand for IT workers in Europe is growing, and Atos Origin has found ways to re-employ such people profitably. But he concedes that his company needs to be careful not to take on too many.

How well this system stands up to competition from India is anybody's guess. A manager at one firm in Europe privately muses that Germany, France and other countries might introduce barriers to IT imports to counter the threat to their domestic employment. If McKinsey is right and sourcing from abroad does make unemployment in Germany and elsewhere worse, protectionist sentiment will grow.

In the end, Europe's big service firms are likely to get round to sourcing production from abroad, as its manufacturing companies have already done. But by that time, says Andrew Parker of Forrester, British and American companies will already have developed much stronger ties with India and other cheap countries, and costs will have risen. This will especially hurt Europe's big financial firms: the biggest banks spend billions of dollars a year on IT. Mr Parker speculates that some European financial firms could be so badly damaged by this loss of competitiveness that they may fall into the arms of fitter American and British rivals. Schwinn could tell them all about it.

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A world of opportunity

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Why the protectionists are wrong

EARLIER this year, a group of politicians from Britain's left-of-centre Labour Party made a field trip to EXL Service, an Indian outsourcing firm in Delhi. Its charming boss, Vikram Talwar, must have worked wonders. On their return, the politicians chided Britain's trade unions for being negative about sourcing work from poor countries, and praised EXL Service's facilities for its workers. These included a health clinic, a gym and a good staff canteen. Laura Moffat, one of the politicians, approvingly told the *Financial Times*: “The benefits EXL offered its employees would be a wish-list for us in Britain.”

More often than not in the past two years, public champions of outsourcing have found themselves bullied into silence. The chairman of President George Bush's Council of Economic Advisers, Gregory Mankiw, got howled off the stage earlier this year when he dared to defend the practice. Lou Dobbs, a TV news anchorman who names and shames unpatriotic American firms that hire workers abroad, is hawking around a new book, “Exporting America: Why Corporate Greed is Shipping American Jobs Overseas”.

Such attacks have instilled caution in some of the big technology firms: IBM, for instance, no longer likes to talk publicly about the growth of its business in India. Yet the backlash against outsourcing has been less violent than people like Mr Dobbs might have hoped; indeed, as the reaction of Mr Talwar's British visitors show, outsourcing is beginning to win support in unexpected quarters.

Protectionists are finding it hard to argue that “corporate greed” is draining jobs from Britain and America when those two economies are close to full employment. More awkwardly still, the very industries said to be badly hurt by the migration of jobs overseas report a shortage of workers at home. Most of the jobs created in India are either in call-centres or at IT firms. But call-centre companies in both Britain and America suffer from rising staff turnover and struggle to recruit more people. Britain's Call-Centre Association, a trade lobby, thinks that employment in the industry in Britain will rise in the next few years; in the United States, call-centre employment is expected to decline slightly.

As IT spending recovers from recession, labour markets in America and Europe are becoming tighter in this industry too. Not many students in rich countries choose to study engineering at college. Even a modest rise in the demand for IT workers in rich countries will create shortages—and therefore openings for Indian, Chinese and Russian engineers.

In the longer run, ageing populations in rich countries will mean labour shortages in many industries. Sourcing some of the work from abroad will ease the problem. It will also help to lift productivity among

rich-country workers who will have to support larger numbers of older people. Moreover, it could help to lower some of the costs of ageing populations, especially in health care. America's health-care spending is rising at 12% a year, far faster than GDP. Farming out the huge job of administering this system to lower-cost countries would restrain such spending. Trade has the same sort of effect, and Americans think nothing of shopping online for cheaper drugs from Canadian pharmacies. Yet, as McKinsey's Diana Farrell points out, it is precisely the supporters of drug imports (and haters of big business) who complain most about jobs going to India.

Anti-globalisers claim that multinational firms that obtain goods and services in low-cost countries exploit the poor by putting them to work in sweatshops. Trade unions and industrial lobbies use such arguments to make their demands for protection look less self-interested, and guilt-wracked American and European *bien pensants* swallow them whole.

The spread of global sourcing may help to unpick these politics. The smartly dressed, brand-conscious young men and women who stroll around the lush technology parks of Bangalore are patently not some new underclass. New wealth in the East will help to expose old protectionist politics in the West. That might provide globalisation with a new legitimacy and moral strength.

This survey has argued that, although the opportunity to source large amounts of white-collar work from low-cost countries has arisen quite suddenly, the work will in fact move over gradually. This will give rich economies time to adjust to new patterns of work, and should keep the politics of change manageable. But from time to time, ugly protectionism is sure to flare up again.

Take it gently

A sudden increase in global competition could force faster and deeper restructuring in rich countries. Big IT-services firms such as IBM and Accenture have scrambled to hire tens of thousands of new employees in India to compete with Indian IT firms such as Wipro and TCS. This could happen in other industries, too, as India becomes expert at providing outsourced banking, insurance and business services.

Office workers everywhere are likely to be discomfited by the rise of Indian firms that promise to do white-collar work cheaper, faster and better. Just as the Japanese car makers licked Detroit into shape, India is going to change life on the cubicle farm forever. So far only American and British firms have sourced much work from low-cost countries, but other rich economies such as France, Germany, Italy and Japan will eventually have to follow as British and American firms reduce their costs and make their rivals look vulnerable. In Japan, France and Germany, this could lift high levels of unemployment (disguised in Japan; explicit in France and Germany) higher still if rigid, unreformed labour markets continue to deny displaced workers new jobs. This is likely to fuel protectionism and cause a backlash.

That may be all the more reason to reassert both the economic and the moral case for free trade. Buying goods and services from poor countries is not only hugely beneficial to rich countries' economies, it can also provide opportunities for millions of people in poor countries to lift themselves up and improve their lives. It is a game in which everybody can win.

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Sources

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For a young topic, outsourcing has produced a huge volume of research, not all of it worthwhile. Here is a sprinkling of some of the better stuff:

From the McKinsey Global Institute

"Offshoring: Is It a Win-Win Game?", August 2003

"New Horizons: Multinational Company Investment in Developing Economies", October 2003

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"China: The Pursuit of Competitive Advantage and Profitable Growth", July 2003

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"The 1988-2000 Employment Projections: How Accurate Were They?", by Andrew Alpert and Jill Auyer, Occupational Outlook Quarterly, Spring 2003

From Forrester

"3.3m US Services Jobs To Go Offshore", John McCarthy, November 2002

"Low-Cost Global Delivery Model Showdown", John McCarthy, August 2044

"Two Speed Europe: Why 1 Million Jobs Will Move Offshore", Andrew Parker, August 2004

I also recommend the excellent “Men and Machines”, by Stuart Chase, The MacMillan Company, 1929. The questions raised by outsourcing have been with us a very long time.

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Offer to readers

Nov 11th 2004
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Media moguls

The paranoia of Rupert Murdoch

Nov 11th 2004
From The Economist print edition

AP

News Corporation's boss is behaving as if he thinks he could lose control of his media company. Could he?

RUPERT MURDOCH, boss of News Corporation, and John Malone, chairman of Liberty Media, have until now behaved like friends and allies in the media industry. But last week Liberty Media announced that it had made a deal with an investment bank that will allow it to raise its holding of News Corporation's voting shares from 9% to 17%. Mr Murdoch reacted as if his fellow media mogul had declared all-out war. On Monday he unveiled a poison-pill “shareholder rights” plan designed to prevent a hostile takeover.

Liberty Media has since tried to calm things down. Its chief executive, Robert Bennett, said that the firm is a “large, happy, friendly shareholder” in News Corporation and that it has no plan to try to wrest control away from the Murdoch family. Mr Bennett also hinted that Liberty Media would simply like the two firms to talk about potential deals. Many analysts think that Mr Malone—the “cable cowboy”, who is widely regarded as the only media deal-maker on a par with Mr Murdoch—wants only to wield extra clout in such talks.

Why, then, did Mr Murdoch go nuclear in response to such a limited threat? After all, his family owns 29.5% of News Corporation's voting shares—making it very hard for it to lose control. Outside investors on occasion carp about corporate governance (what's that?) and the role of the family in the firm, but they more often laud its profitability and strategy.

Yet Mr Murdoch was clearly extremely upset that Liberty Media gave him no prior warning of its plan to acquire more voting shares. Indeed, this is the second time that Mr Malone has bought News Corporation voting shares “in the middle of the night without telling us”, as one executive at the firm puts it. In January, he bought his 9% voting stake and only later called Mr Murdoch, who did not accept the logic of his explanation—tax and a split of Liberty Media's business into domestic and international chunks—and became suspicious.

The cowboy versus the digger

Mr Malone is not merely grasping an opportunity to take a bigger position in a company he likes. Nor is he likely to want just a few minor asset swaps. He is deeply frustrated with the performance of his own firm, an aggregation of large and smaller stakes in other media firms. He wants to use News Corporation to sort out his problems. Richard Greenfield of Fulcrum Global Partners, an independent research firm, estimates that Liberty Media's share price trades at a 32% discount to the underlying value of its assets. The chief reason is the complexity of its structure, and the lack of a clear strategy.

For the time being, Mr Murdoch's poison pill will stop Mr Malone acquiring more voting shares. If he lifts his stake beyond 17%, the pill will give other shareholders the right to buy more shares at half price. Liberty Media's stake would be heavily diluted. The rights plan has to be ratified by shareholders in a year's time. According to Mr Greenfield, top News Corporation shareholders he has spoken to are inclined, at least for now, to support it in order to keep Mr Murdoch in charge.

But even with a robust defence in place, Mr Murdoch is rattled, people close to him say. In theory, another investor could buy 14.9% of News Corporation's voting shares, without triggering the rights plan, and gang up with Liberty Media. The brilliance of Mr Malone's move, indeed, is that his cloak-and-dagger tactics play perfectly upon Mr Murdoch's long-standing fear of losing control of News Corporation. He almost had to hand the firm to his creditors in 1990, having invested heavily in printing-press improvements and on a new venture, Sky TV. His family's stake used to be larger, but has been whittled down by successive acquisitions and issues of shares. Now it is small compared with some other families on top of media firms: Sumner Redstone, for instance, owns 71% of Viacom's voting shares.

Though Mr Malone cannot do very much with 17%, he is betting that Mr Murdoch will now do deals that he would normally reject just to see the back of him. Liberty Media is likely to try to unload assets it does not want on to News Corporation. Its Starz Encore Group, a pay-movie business, for instance, is troubled. Mr Malone may also try to pressure News Corporation into paying a high price for Liberty's best bits, such as Discovery Communications.

Does Mr Malone, who is ten years younger than Mr Murdoch, harbour an ambition to run News Corporation? No one knows, except the cable cowboy himself. He is a loner who sits by himself in Denver, Colorado, and plots, says one rival media executive. Yet he surely wants to revive his reputation, which has declined since the 1980s, when he used TCI, a cable company, as a vehicle to grab large stakes in programming firms in return for distribution on his network. Mr Malone has become less important in an increasingly consolidated media industry.

And succession is clearly becoming an issue at News Corporation. Mr Murdoch wants to hand over control of the firm to his sons, Lachlan and James. The succession could be the point at which Mr Malone makes a bid for control, if that is what he is after, especially if Peter Chernin, Mr Murdoch's second-in-command, leaves to be chief executive of Disney next year.

The hitherto Australian News Corporation has just reincorporated in Delaware—ostensibly to attract more American investors, but perhaps because the state affords ample protection (such as poison pills) to entrenched corporate bosses. But big American institutional investors have recently become more assertive. British and Australian investors have in the past berated Mr Murdoch. At two other media firms, Disney and Hollinger International, moguls who thought they were unchallengeable have been brought down—albeit for very different reasons. Just because Mr Murdoch's behaviour looks a tad paranoid, it does not mean someone is not out to get him. Or that they won't succeed.

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Video games

The Halo effect

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Games sales exceed movie box-office receipts. But are the two comparable?

Reuters

Proof that gamers aren't sad loners

THERE is nothing the video-game industry likes more than boasting about how it is bigger than the film business. For this week's launch of “Halo 2”, a shoot-'em-up that runs on Microsoft's Xbox console, over 6,000 shops across America opened their doors at midnight to sell the game to queues of fans. Add over 1.5m pre-orders and the game brought in over $100m in its first day on sale. Bill Gates, Microsoft's chairman, called it “an opening day that's greater than any motion picture has ever had in history.” For example, “The Incredibles”, the latest blockbuster film from Pixar, took a mere $70.5m in its opening weekend, while the record for an opening day's ticket sales, at $40.4m, is held by “Spider-Man 2”. Overall, annual game sales, at around $20 billion, now exceed box-office receipts.

But the two are not really comparable. Film-going is mainstream: nearly everybody does it at some time. Around 10m people saw “The Incredibles” last weekend, and perhaps 50m people will see it in cinemas eventually. Even more will view it on television, DVD, or on a plane. Playing video games is still a minority sport, though its popularity has soared. Not everybody wants a games console. It is only because games cost so much more than film tickets ($50 versus $7) that games can outsell films, despite their narrower appeal.

Games and films would be more comparable if more people played games, there was no need to buy a console, and individual games cost as little as film tickets. All of that describes mobile-phone gaming. Having moved from the bedroom to the living room, gaming is now moving on to the mobile handset, says Brian Greasley of Digital Bridges, a mobile-games firm.

According to the latest Mobinet study of 4,500 mobile users in 13 countries by A.T. Kearney, a consultancy, and the Judge Institute of Management at Cambridge University, the number of people who download games to their phones grew in the past year to 10% of the world's 1.7 billion mobile users, exceeding the number of console users.

The fragmented mobile-games industry is consolidating fast, and there are more higher quality games based on big franchises such as Spider-Man. Jamdat, a mobile-games firm, went public in October. Most tellingly of all, the big boys are moving in. “There is the potential for a massive market in the future,” says Bruce McMillan of Electronic Arts, the world's biggest games publisher, “so it makes sense for us to have a stronger presence.” Yet Screen Digest, a consultancy, reckons that the value of the mobile-gaming market will only exceed $1 billion for the first time this year. Small change next to the film business—but, perhaps, the more valid comparison.

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Oil companies

The next scandal?

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In the wake of the Shell scandal, there are doubts about reserves at other firms

“THERE is something strange going on in this industry,” says Jeroen van der Veer, the boss of Royal Dutch/Shell. He suspects that his firm, far from being the nasty exception it has been portrayed as being, is merely the first to face a problem that is industry-wide. Mr van der Veer got the top job at Shell after a scandal involving overbooking of “proved” oil reserves that brought down his predecessor, Sir Philip Watts, and also prompted the firm to abandon its arcane bi-national dual-board structure. Industry analysts and investors are quietly saying that Mr van der Veer may be right, and that another big reserves scandal may be brewing somewhere.

Shell, says Mr van der Veer, is like a “naughty schoolboy that has been caught”. If other firms had to apply the rules on what can be called “proved” reserves set by America's Securities and Exchange Commission (SEC) as diligently as Shell now does, would they also have to make substantial revisions to their reserve figures? Lysle Brinker of John Herold, a consultancy, thinks so. “I would bet money that is the case,” he says. “But we just don't know at which firms.”

He worries most about firms that classify a large part of their “proved reserves” as “undeveloped” assets that have not undergone the irrefutable test of actual production. Analysts and investors now whisper that BP, with a high share of such undeveloped proved assets, is ripe for revisions—a charge the firm roundly rejects.

Consider Ormen Lange, a North Sea gas field shared by half a dozen oil giants. Though all have access to the same geological data, each firm has booked a different proportion of its stake as “proved”—ranging from Shell's estimate, revised, post-scandal, to about 20% (down from over 60%) to BP's at over 80%. BP will not comment other than to say that it is standing by its estimate, and to confirm that it is selling its stake in that field. “Why is BP booking the gas as 80% proved?” asks Eric Knight, an activist investor representing the giant CalPERS pension fund, “and why is it in such a hurry to sell?”

If the reserves problem at Shell does not grow into an industry-wide scandal, one reason may be today's high oil prices. Firms that had used unrealistically low cost estimates for extracting oil from ageing fields have suddenly been bailed out of trouble by the price rise, which makes extraction viable, and thus reserves proved, even at a higher cost. And perhaps the Shell affair may force the SEC to update its rules for proving reserves, which Mr Brinker calls “archaic”. They make no use of modern technologies such as seismic testing and lateral drilling, for instance.

Mr Knight would prefer the SEC to require instead a measure known as “2P”— proved plus probable reserves. Using that measure, Shell would have avoided trouble. The SEC opposed using 2P, but recently said it will allow seismic data to be used in judging whether reserves are proved, but only in the Gulf of Mexico—a decision that one oil executive called “capricious and bizarre”.

Meanwhile, Mr Knight is pinning his hopes on external auditors. “If Shell agrees to an external audit of all of its reserves, this would strongly encourage others to do likewise and would help to eradicate inconsistencies in the application of the SEC's standards that have undermined market confidence in the sector.” Over to you, Mr van der Veer.

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Corporate governance

Staggering

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Things are slow to change in America's boardrooms

THE annual review of American company board practices by Korn/Ferry, a firm of headhunters, is a useful indicator of the health of corporate governance. This year's review, published on November 12th, shows that the Sarbanes-Oxley act, passed in 2002 to try to prevent a repeat of corporate collapses such as Enron's and WorldCom's, has had an impact on the boardroom—albeit at an average implementation cost that Korn/Ferry estimates at $5.1m per firm.

Two years ago, only 41% of American firms said they regularly held meetings of directors without their chief executive present; this year the figure was 93%. But some things have been surprisingly unaffected by the backlash against corporate scandals. For example, despite a growing feeling that former chief executives should not sit on their company's board, the percentage of American firms where they do has actually edged up, from 23% in 2003 to 25% in 2004.

Also, disappointingly few firms have split the jobs of chairman and chief executive. Another survey of American boards published this week, by A.T. Kearney, a firm of consultants, found that in 2002 14% of the boards of S&P 500 firms had separated the roles, and a further 16% said they planned to do so. But by 2004 only 23% overall had taken the plunge. A survey earlier in the year by consultants at McKinsey found that 70% of American directors and investors supported the idea of splitting the jobs, which is standard practice in Europe.

Another disappointment is the slow progress in abolishing “staggered” boards—ones where only one-third of the directors are up for re-election each year, to three-year terms. Invented as a defence against takeover, such boards, according to a new Harvard Law School study by Lucian Bebchuk and Alma Cohen, are unambiguously “associated with an economically significant reduction in firm value”.

Despite this, the percentage of S&P 500 firms with staggered boards has fallen only slightly—from 63% in 2001 to 60% in 2003, according to the Investor Responsibility Research Centre. And many of those firms that have been forced by shareholders to abolish the system are doing so only slowly. Merck, a pharmaceutical company in trouble over the possible side-effects of its arthritis drug Vioxx, is allowing its directors to run their full term before introducing a system in which they are all re-elected (or otherwise) annually. Other companies' staggered boards are entrenched in their corporate charters, which cannot be amended by a shareholders' vote. Anyone who expected the scandals of 2001 to bring about rapid change in the balance of power between managers and owners was, at best, naive.

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German corporate disclosure

No quarter given

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Porsche's stand against short-termism

Reuters

Who needs the DAX anyway?

ITS CARS may be fast, but Porsche's reporting of its financial performance is not. Europe's most successful carmaker has been fighting hard against the global trend towards real-time corporate financial transparency—a war in which it lost another battle this week.

Back in August 2001, Porsche was expelled from the M-DAX, Deutsche Börse's stockmarket index for mid-size companies, after refusing to comply with the exchange's new demand for quarterly reporting of results by firms included in its indices. Deutsche Börse argued that quarterly reporting is best practice in the international capital markets. Porsche disagreed, arguing that reporting every three months leads firms to think short-term and to lose sight of long-term strategy.

The advantage of being in an index—and Porsche's size would probably now admit it to Germany's top index, the DAX—is that it attracts the biggest institutional investors, and so reduces the cost of capital. Yet, so far, Porsche's semi-annual reporting and its exit from the M-DAX have done it no harm. It has made record profits in each of the past six years and announced in September that profits this year would top *euro*1 billion ($1.3 billion). It also keeps shareholders up to date with around 40 ad hoc statements a year, rather than quarterly figures. Its stance is essentially a matter of principle—or, perhaps, a means of attracting some useful publicity.

This week, Porsche's hyperactive lawyers abandoned an attempt to get a judge in Frankfurt to force Deutsche Börse to back down after the judge suggested that the exchange is entitled to set any criteria it pleases for entry into one of its indices. If Porsche does not like it, he observed, it can always set up its own exchange, since Deutsche Börse is not a monopoly.

Yet Porsche's stance is not without merit. Quarterly reporting is the norm in America, but is not typically required in Europe—not even for FTSE companies listed in London. The European Union's financial transparency directive, agreed this year, falls short of demanding quarterly reporting—although it recommended that the concept be tested over the next five years. The Association of British Insurers and the Association Française de la Gestion Financière last year each gave warning to Europe's lawmakers about the potential threat of quarterly reporting to the stability of financial markets.

Porsche, anyway, is undaunted. Last month it filed a new case with a higher court. But that will not be heard for at least two years. Meanwhile, Porsche will just have to cruise along, outside the DAX.

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GE in India

Out of captivity

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A landmark deal for India's remote-services industry

THEY invented the game; now they have changed the rules. General Electric's back-office services arm, GE Capital International Services, or GECIS, is one of the oldest and biggest of India's business-process outsourcing (BPO) outfits. Formed in 1997, it has been a model for hundreds of other firms that have sought to cut costs by shifting to India back-office jobs that can be performed remotely (see our survey of outsourcing in this issue). On November 8th, GE announced that it is to sell 60% of GECIS to two private-equity firms. GECIS's boss, Pramod Bhasin, calls the deal “trend-setting”. Even a competitor says that it is “game-changing”.

GECIS employs about 13,000 people in India and a further 4,000 in America, China, Hungary and Mexico. It sells services such as call-centres, accounting, insurance-claim processing, supply-chain and IT management, and technical support. Almost all of its customers are other businesses within GE. Profits are not known, but GECIS is widely seen as a great success, setting not just trends but standards. Its growth, like that of many of its rivals, has been phenomenal. From $26m in 1999, revenues are likely to be $420m this year and over $500m next year, when it will have 23,000 workers.

That sort of pace would be hard to maintain while GECIS relies for its business almost exclusively on other parts of GE. But selling its services outside is hard so long as it remains a GE “captive”: potential customers worry about how high a priority they would have, especially since many are likely to be, in one business or another, GE's competitors.

Another reason for GE to sell is that back-office services are not part of its core technology business. A third is presumably the price. The buyers, General Atlantic Partners and Oak Hill Capital, will pay $500m for their 60%, valuing GECIS at about two years' revenues. In April, IBM bought Daksh, an Indian call-centre firm, reportedly for only about 18 months' revenues. But General Atlantic's Steve Denning points out that GE's continued stake gives it an interest in selling for a fair value.

“Captive” BPO operations have been among the commonest vehicles for moving work offshore, especially among banks. HSBC, American Express, Citigroup and Standard Chartered all have big Indian BPO captives. But captives also typically suffer, after a while, from limits to growth and mounting costs. In a business now suffering from giddy job-hopping, GECIS boasts the lowest staff-attrition rates in the country. But, says a rival, one explanation is that firms such as his simply cannot afford GECIS-style perks.

Ashish Gupta, of Evalueserve, a research firm, estimates that, in general, captives' costs are between 20-30% higher than those of independent firms. Too often expatriate managers come and go, adding costs and breaking management continuity. Those performing the back-office functions shifted to India often come to be seen as second-class corporate citizens.

That, at least, is the sales pitch of the independent service-provider. But some things are better kept in-house. In customer service, in particular, a firm's reputation is at stake. Even GE is retaining 1,000 of GECIS's Indian staff on its own books to do things it prefers not to outsource even to a related firm. Still, for firms contemplating moving service jobs to India for the first time, GE's decision will weigh heavily in the balance against setting up a captive. That is good news for the existing third-party providers. Less pleasing is the prospect of a hungry new competitor.

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Harmony and Gold Fields

Feverish

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Tempers fray as a hostile bid rolls on

IT MAY create the world's biggest gold producer, at least in terms of output. That excites those who foresee the industry consolidating into a few mammoth firms, or those simply feverish from the surge that carried gold briefly to $437 an ounce this week. But so far the bid by Harmony, a South African gold miner, to grab Gold Fields, a bigger local rival with tempting ore reserves, has led mainly to hype.

In New York this week Harmony's ebullient chief, Bernard Swanepoel, raged that Gold Fields had labelled him “a criminal” by saying that he exaggerated his firm's reserves. His rivals lack judgment, he jeered, wasting money on thick office carpets, instead of mining the yellow stuff. Gold Fields hit back, sneering that Harmony's share price had slumped by some 17% since it announced its “ill-conceived” and unwanted bid on October 18th.

That is troubling for Mr Swanepoel: the value of his all-share offer is far below the $8.1 billion first announced. And his own shareholders had yet to vote, on November 12th, to back the bid. Gold Fields has launched legal actions in South Africa and America to block it. Their merits are unclear: Harmony this week defeated two challenges to its two-stage bid (34.9% first, just below South Africa's threshold for a compulsory full bid, the rest later). But they take time and threaten, at least, delay.

Mr Swanepoel has written to his rival, Ian Cockerill, offering peace talks, and been briskly told to take his bid off Gold Fields' lawn. But he already had one big backer among its shareholders: Norilsk Nickel, a Russian firm with over 20%. Its boss, Vladimir Potanin, never warmed to Mr Cockerill, and dislikes his pricey plan to buy a Canadian firm, IAMGOLD, and put Gold Fields' mines abroad into the resulting entity, separate from its South African ones, which are far costlier to work.

Harmony says no: scrap the Canadian link-up, cut costs by 15% in the South African mines, lift profits despite the strength of the rand. “Statistics” are now flying to show that one side or the other is better placed to cut costs. Harmony, which began talking of 1 billion rand, now says it could trim 17 billion ($2.8 billion) at Gold Fields: economies of scale, better use of capital, fewer staff and no more plush carpets. In all, cheaper mining. Harmony has already pulled off similar feats, prolonging the lives of mines that others had dumped.

Gold Fields this week put out its own figures, to show that it mines 15% more cheaply than Harmony, per kilo of gold, and needs no lessons from its rival. It talks of more cost-cutting, but not if it threatens long-term deep mining of rich ores.

Unless Harmony's shareholders or Gold Fields' lawyers halt it first, the battle will last at least to November 26th, when the first stage of Harmony's bid is due. The rest of the industry is watching carefully. Some huge companies have indeed been born of mergers in the past couple of years. But bigger is not always better. South Africa's AngloGold bought Ghana's Ashanti Goldfields earlier this year, and now has 22 operations in 11 countries. But its remote activities are proving costlier than expected, and its share price is down.

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Intellectual property

The cost of ideas

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It is becoming ever more apparent that the patent system isn't working

INTELLECTUAL property is the cornerstone of the modern knowledge economy. But one of the main forms of intellectual property, the patent—a temporary monopoly designed to provide an incentive to innovate—is increasingly being found wanting, even as the number of applications soars at patent offices around the world. America's patent system has “become sand rather than lubricant in the wheels of American progress”, argue Adam Jaffe and Josh Lerner in a new book, “Innovation and its Discontents: How our broken patent system is endangering innovation and progress and what to do about it” (published by Princeton University Press). The world's patent system remains splintered along national lines, yet the system's defects are felt everywhere.

“Patent offices are under incredible pressure,” says Dominique Guellec, the chief economist at the European Patent Office in Munich. Applications at many patent offices have doubled in the past ten years, and the average length of each submission has increased by 50%. The average quantity of work required to examine an application is three times greater than it was a decade ago. “Of course that can't be neutral in terms of quality,” says Mr Guellec.

In recent years, the scope of patents has broadened to encompass new technologies, as well as software, and in some instances business methods. Meanwhile, the legal power of patents, once awarded, has increased, and they are more zealously sought. This, combined with an alleged decline in the quality of patents—that is, how accurate their claims are and whether they are truly novel or non-obvious—is deeply troubling, especially as, once awarded, a patent is hard to revoke.

Patently absurd

In America, several controversial business-method patent awards, notably Amazon's one-click payment process, have fuelled the perception that the Patent and Trademark Office (PTO) is under strain. A study by M-CAM, an intellectual-property consultancy, found that over 30% of patents make duplicate claims, raising questions about their validity. America's PTO dismisses the criticism as anecdotal. “We're seeing lots of new industries being born, that is why there are a lot more patent applications,” says Mary Critharis of the PTO.

The number of patent applications to the PTO is growing at around 6% a year. The wait for a decision is on average 27 months—and much longer for complex applications in advanced sciences. Last year, the PTO received around 350,000 applications and currently has a backlog of over half a million to review. It is a global concern: foreigners account for around half of all patents granted.

Similar growth is occurring elsewhere, including in countries that previously showed little interest in intellectual property. Applications to China's patent office increased fivefold from 1991 to 2001. As countries such as China, South Korea and India spend more on research and development, they are filing more patents.

The mission creep of America's patent system into more contentious areas is also spreading elsewhere. Later this month, the European Council of Ministers will discuss draft legislation on harmonising policy on computer-implemented innovations. Many small software companies in Europe, as well as “open-source” software developers that make non-proprietary software, oppose the initiative. They fear that it is a first step towards adopting controversial software patents, already awarded in America, which could block different implementations of the same features. Were further proof needed that this may not be an entirely positive development, look no further than the mighty software monopolist, Microsoft, whose

chairman, Bill Gates, has called on employees to increase the number of patents that the company files.

The rising importance of patents has led both to an arms race and a game of bluff. Many firms in the information-technology and life-sciences industries say they have an incentive to obtain as many patents as possible as bargaining chips in litigation. The patents are used to reach a cross-licensing agreement, usually with some cash thrown in, so that both firms can continue to do business. Those firms that lack patents are thus disadvantaged.

Countries increasingly complain to the World Trade Organisation and the United Nations World Intellectual Property Organisation (WIPO) that the patent system discriminates against them. Indeed, WIPO recently adopted a “development agenda” to consider different intellectual-property regimes appropriate to the circumstances of a particular country or region. This was hailed as a boon for reassessing patent protections on drugs and for open-source software. Poor countries have long complained that America is trying to export its tough intellectual-property protections.

The growing debate about America's patents is focused on the process of examining applications and the difficulty of challenging dubious patents. Patent examiners typically know less about an invention than the applicant. Moreover, their workload is far higher for rejecting than granting an application. This creates a perverse incentive for examiners to “dispose” of applications by granting rather than rejecting them, argue Messrs Jaffe and Lerner in their new book. To resolve this, they call for a pre-grant notice period when third parties can come forward with “prior art” that would invalidate the patent.

As for the second problem, legislation introduced into America's Congress last month seeks to make patent-opposition trials easier for challengers by eliminating some legal hurdles. The legislation would also curb the granting of many forms of business-method patents.

As these reforms are debated, the scale and central importance of the patent system are also coming under assault. “The innovation system is broken in that there is too much emphasis on intellectual-property rights,” says Suzanne Scotchmer, the author of “Innovation and Incentives” (MIT Press), a book on the role of patents to be published soon. More than ever, she says, inventions that would otherwise go into the public domain because they are funded by taxpayers or charities become “cordoned off” by the patent system. If so, perhaps the patent system not only needs to be repaired, but shrunk?

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Face value

Growing pains of the Cisco kid

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AFP

Can John Chambers get Cisco out of its premature middle-age funk?

APPROACHING the 20th birthday of Cisco, the world's largest maker of networking equipment, and his own tenth anniversary as chief executive, John Chambers has lately been telling people, in his soft West Virginian drawl, that he is “having fun again”. On November 9th, to prove it, he announced a good start to Cisco's 2005 financial year, with revenue up by 17% over the first quarter of fiscal 2004, and profits up by 29%.

But those who have watched him over the years know that if Mr Chambers (aged 54) is upbeat today, it is in that gratefully relieved way of somebody in middle age who finds that he can still get his numbers up at all. Just recall Mr Chambers during the first half of his tenure, which coincided perfectly with the internet boom at its most youthfully optimistic. As the internet's preferred plumber—Cisco makes the switches and routers that steer all those packets of digital information through and between networks—Mr Chambers became its hero. In 2000, Cisco was even, briefly, the most valuable company in the world, and Mr Chambers was predicting revenues of $50 billion by 2004. Instead, actual revenues in 2004 were $22 billion, and Cisco's shares are today at around one-quarter of their boom-time high.

The irony in all this is that Mr Chambers was never, even in the giddy days, all that wrong in his predictions for the internet's expansion. According to Tal Liani at Merrill Lynch, an investment bank, internet traffic will keep growing by some 70% a year for the foreseeable future, as everything from corporate data storage to telephone calls and video conferences increasingly gets transported in digital packets over networks. Cisco still has a market share of between 70% and 85% in network switches and routers, so anything that makes network traffic go up should also overwhelmingly favour Cisco.

The problem is that the price of bandwidth is dropping faster than traffic is growing, says Mr Liani, so that Cisco's revenues in the long run are likely to trend “either flat or down”. Unless Mr Chambers wants to settle for a comfortable life (which he shows no sign of doing), his challenge is therefore not merely to keep routing and switching additional network traffic, but to get on top of the technological trends that are generating that traffic by making new gadgets for new uses. In that sense, says Michael Ladam at Stratecast, a research firm, Cisco is a bit like makers of televisions who get excited not when broadcast channels are added, but when digital broadcasts replace analogue ones, because that is when consumers need to buy new sets.

Mr Chambers needs no convincing on that point. On the one hand, Cisco is still fighting fiercely to stay ahead of technologically savvier rivals such as Juniper in its core business of switches and routers. Last year, for instance, it released the CRS-1, a router that looks like three industrial-sized refrigerators in a row, costs over $1m, and is known inside of Cisco only by the vulgar acronym HFR, for “huge fucking router”. On the other hand, Cisco is sweating hard to make and sell new kinds of gear. The main danger in this strategy is that Cisco will come up against new, and possibly stronger, rivals.

One instance is the booming market for “voice over internet protocol” (VOIP)—ie, telephony delivered over the internet instead of circuit-switched telecoms networks. Many firms are switching to VOIP because it is dramatically cheaper or even free (as long as a call need not interact at all with the traditional phone network) as well as much more convenient—voice-mail and e-mail all go into one inbox, for instance, and are accessible from any internet connection anywhere. To make that switch, firms need to replace their old switchboards (called private-branch exchanges, or PBXs) and telephones, and Cisco is happily selling them new internet PBXs and internet handsets.

Indeed, this opportunity is so promising that Mr Chambers considers it a future core business. During the latest fiscal quarter, Cisco sold 180,000 internet phones to Bank of America and 50,000 to Ford, and it shipped more than 1m to Europe. On the other hand, Cisco has (as yet) nothing like the market dominance in internet phones that it has in routers and switches. After an embarrassing technical glitch, for instance, it recently lost Merrill Lynch as a VOIP customer to Avaya, a more specialised rival. Lucent and Nortel are also poised to compete strongly in VOIP.

Gamma male

Cisco's competitive position is, if anything, even worse in the other growth markets it has identified. The fight to be the alpha male in the market for corporate data-storage networks, which are huge consumers of network bandwidth, is between two focused makers of storage switches, Brocade and McData. Cisco is a distant third. In another very promising market, that for wireless and wired home networks, Cisco has bought itself a strong consumer brand called Linksys, but it is up against stiff competition from firms such as D-Link, 3Com and Netgear. Even when it comes to making corporate networks more secure, a natural product extension for a router maker, Cisco is behind firms such as Check Point, the leading maker of firewalls.

In a way, all this loops back to the original dilemma. Cisco, the router company, is ageing gracefully in an unexciting market; Cisco, the cocksure attacker of new markets, is discovering that lots of muscular lads are there already. So Cisco is adding one more strategic effort. Cisco wants to become a “trusted business partner, not just a router company”, says Mr Chambers. What this really means, says Deb Mielke, an industry consultant, is that Mr Chambers intends to emulate IBM, where he once worked, by transforming Cisco gradually from a boxmaker into an army of network consultants and integrators who charge for services as well as, or even instead of, hardware. That might indeed help him to grow revenue, although it really does sound a bit old and grey.

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The textile industry

The looming revolution

Nov 11th 2004
From The Economist print edition

ImagineChina

China, the world's workshop, is poised to become its tailor. What will happen to textile industries elsewhere, especially in South Asia?

THE shirt on your back probably had an exotic life before it reached you. Say you bought it in America and the label said it was “Made in Sri Lanka”. It may well have been made from Chinese fabric, woven from Chinese yarn, spun from Chinese cotton or man-made fibre. Why, you may wonder, was your shirt not actually cut and sewn in China? We know they have scissors and sewing machines there and millions of nimble-fingered operators. After all, many of the other shirts on the shop hangers were indeed made in China.

The question is being asked with increasing urgency in China, too, as well as in Sri Lanka, Bangladesh, Nepal, Cambodia, El Salvador, Honduras and more than 40 other countries with thriving clothing industries based on exports. They are bracing for the scheduled elimination, at the end of this year, of quotas that have governed their exports to the world's two biggest markets: America and the European Union. The quotas have restrained some countries' exports, but in others have created an export industry that might not otherwise have existed.

China is definitely in the first category—its sales in America and Europe will surely grow once quotas are lifted. The questions are: by how much? And what will be done to impede their growth? The American government is under pressure from its own manufacturers to stem a potential flood of Chinese imports. Mechanisms to do this, so-called “safeguards”, were built into the agreement that America signed with China in November 1999 as part of China's accession to the World Trade Organisation (WTO).

A big trade row seems inevitable. American manufacturers want their government to maintain 15 of the 91 quotas that expire at the end of the year—including those for trousers, shirts, sheets and underwear. They also want to keep limits on imports of three products—bras, dressing gowns and knitted fabrics—for which quotas were lifted in 2002 and the “safeguards” subsequently invoked.

The deadline for a government decision on whether to accept the first of these petitions (cotton trousers) fell on November 1st, the eve of the presidential election. The manufacturers had milked as hard as they could the political implications of their bid for protection, saying that China will “destroy” the American textile industry. Trade unions also weighed in, saying that 350,000 jobs have been lost in America's textile sector in the past three years, and that, if nothing is done, many of the remaining 695,000 will

likewise soon be on a fast boat to southern China. Sure enough, the petition was granted. America is now looking into whether it will impose safeguards on five other categories of clothing, and will decide by next February. If imposed, these new quotas will limit China's export growth to 7.5% in each category.

China has responded robustly, arguing the “safeguards” were designed to correct actual import surges, not threats yet to materialise. American textile importers and buyers accuse their compatriot manufacturers of trying to achieve through government intervention what they have failed to manage through investment, planning and improving productivity: becoming internationally competitive.

It is not just the rich world's garment-makers that are alarmed. Trade associations from more than 50 countries have signed the “Istanbul declaration”, asking the WTO to keep the quotas for a further three years. They include groups from poor and middle-income places such as Bangladesh, Sri Lanka, Indonesia, Morocco, Tunisia and Turkey.

The declaration argues that circumstances have changed dramatically since the phasing out of quotas was agreed. It claims that the admission of China to the WTO at the beginning of 2002 was not contemplated at the time. (In fact, China had tried hard to become a WTO founder member in 1995.) More to the point, it accuses China of keeping its currency at an artificially low level, and of other dirty tricks such as “state subsidies and the proliferation of non-performing loans and rebate schemes”. Of course, if they are right, this applies to almost all Chinese exports, not just textiles.

The signatories to “Istanbul” fear the end of quotas will mean the loss of important inflows of foreign exchange, the closure of some businesses and the loss of as many as 30m jobs to China's allegedly encroaching global monopoly. The worry is that, having no natural comparative advantage beyond abundant cheap labour, they will lose market share to countries with vertically-integrated supply chains—ie, those that produce their own fibre, yarn, fabric and clothes.

Above all, that means China. But Chinese manufacturers are not the only ones expecting a bonanza. In India and Pakistan, too, many see a moment of great opportunity. For South Asia as a whole, the impact of the end of the quota regime is potentially enormous. In poor countries with small manufacturing bases and a vast rural majority, garmentmaking offers a labour-intensive way of lifting people out of poverty. Sudhir Dhingra, boss of Orient Craft, India's largest apparel exporter, which employs about 18,000 people, says that each machine he buys creates four jobs in his factories and another four outside. In a typical factory, he says, four-fifths of the workers will have started life as poor villagers. Few will have had more than an elementary education.

I wouldn't start from here

Clothing is one of the most basic of human needs, and its international trade one of the oldest. Along with food, it is also most subject to artificial distortions. The demise of the biggest such distortion, the quota regime, was agreed a decade ago. The Agreement on Textiles and Clothing (ATC) came into force, along with the WTO itself, in 1995. It covered the staged elimination of quotas in America, Canada and the EU (as well as Norway, which removed its last quotas in 2001). It was intended as a bridge between the old Multi-Fibre Arrangement, which had covered textile trade since 1974, and the full integration of the trade into the multilateral system.

By 2002, imports to the ATC countries, not counting internal EU imports, accounted for 43.5% of a global textile and clothing trade estimated at $360 billion. Under the ATC, quotas were to be lifted in four stages. But nearly half—49% of import volume—was to be left to the last moment: January 1st 2005. In practice, America chose to “integrate” low value-added items and many that were covered by under-used quotas. As a result, some two-thirds of American textile imports, including 80% of clothing imports, or $61 billion, are subject to quotas until the end of this year. In a survey by Goldman Sachs, an investment bank, 71% of American and European manufacturers, wholesalers and retailers said they at present base more than 20% of their sourcing decisions on quotas. Hence the panic.

There is an historic irony that poor countries should be quaking at the prospect of textile-trade liberalisation. They have long demanded the dismantling of rich-country protection in an industry where they should have most to gain. Quotas that expanded before eventually vanishing were supposed to allow them to take advantage of their low-paid workforces. It seems a long time ago now, but in the early 1980s they witnessed the

emergence of three Asian producers—Hong Kong, South Korea and Taiwan—as big exporters of cheap clothes. At their peak, these three accounted for nearly a third of world clothing exports. In 20 years, that share has fallen to 8%, as lower-cost countries have taken away their markets.

Quotas have worked, up to a point, in bringing business to poor countries. But they have had some perverse effects. Firstly, the manufacturing process has become ludicrously cosmopolitan—the Sri Lankan shirt described above had had a sheltered life. “The textile supply chain”, says Arvind Singhal, of KSA Technopak, a Delhi-based textile and retail consultancy, “looks like a Dali painting.” Fine Indian cotton might be turned into fabric in Italy, cut in America, sewn in Honduras and sold back to America.

Second, some countries that had no mechanised textile industries at all until a few years ago have become dependent on them. For example, as Cambodia emerged in the 1990s from three decades of isolation, horror, civil war and Vietnamese occupation, quotas brought foreign investment, especially from Hong Kong and Taiwan, in clothing factories. Their products now make up more than 70% of the country's merchandise exports. The proportions are even higher in Bangladesh and Macau. In Pakistan, Mauritius and Sri Lanka it is also above 50%.

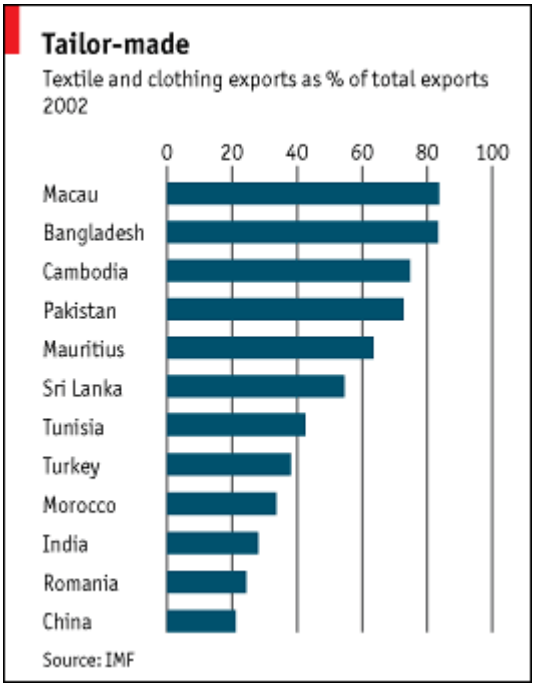
The Indian hope trick

D.K. Nair, of the Indian Cotton Mills Federation (ICMF), an industry lobby, argues that American quotas turned China's textile industries into a Frankenstein's monster. As many Indians see it, China's quotas were set generously in the 1980s for political reasons. This explains the Chinese industry's hectic expansion. By contrast, India's growth was artificially stunted. The entire Sri Lankan and Bangladeshi garment industries were, he argues, “an offshoot of our quota problems”.

So Mr Nair sees the recent tear-jerking appeals on behalf of countries such as Bangladesh as hypocritical. By portraying China as the only beneficiary of the liberalisation, American industry is hoping to garner international backing for its protectionist impulses.

“Welcome”, read the digital display at the entrance to one of the huge exhibition halls in Delhi that made up the Indian Handicrafts and Gifts Fair in October, “to the next best”. It is a fitting, if presumably unintended, slogan for India's textile industry. The refrain repeated time and again by post-quota bulls is not that India is a world-beater. More an egg-beater: “nobody,” the bulls say, “wants to put all theirs in China's basket.”

Mr Dhingra is one such optimist, arguing that India is a “very good second option.” He is adding 30% to Orient Craft's capacity, opening three new factories this year and two in 2005. He candidly accepts that in many products, China offers buyers a “more attractive and cheaper option.” For example, he says, it is “now impossible to make money out of children's clothing.” China's prices—45 US cents an item—are simply unbeatable.



Many buyers, however, still need to hedge their bets. KSA Technopak's Mr Singhal agrees. China will not swamp the global market because prudent supply management demands diversification. Even if one ignores the political risks of dependence on China, recent disasters around the world have been diverse enough to reinforce the message: terrorist attacks, hurricanes, earthquakes, SARS—all can disrupt supply lines. Wal-Mart, the world's biggest retailer and buyer of about one-tenth, or $15 billion-worth, of

China's annual exports to America, stresses its desire for a steady and geographically diverse supply of product.

India recommends itself as what Mr Singhal calls a “secondary base”. It is an English-speaking democracy. It is, after China and America, the world's third-largest cotton producer. Reliance, an Indian firm, is the world's biggest polyester maker. With 34m spindles, India is, next to China, the world's biggest yarn-spinner. It has huge clothing and carpet industries with centuries of history behind them. Wajahat Habibullah, the government's textiles secretary, points out that the wealth of the Mughal empire, which gave way to the British Raj, was founded on carpets and textiles.

A very fine yarn

The ICMF, the Indian manufacturers' lobby, has forecast that Indian textile exports can grow at 18% a year to reach $40 billion by 2010, making up more than a third of the country's merchandise exports, compared with a quarter at present. In the process, 5m jobs would be created, so that the industry, already India's second-biggest employer after agriculture, will have 40m workers.

A WTO study backs the optimism. It expects India's share of the American market to increase from 4% to 15%, as against a jump from 16% to 50% for China. The losers would be Mexico, South America, the EU, Africa and the Middle East. But there are doubters. India's industry is still dominated by thousands of small family-owned firms. Many lack the marketing skill to take advantage of the new freedoms. Nor is the industry universally admired. In neighbouring Sri Lanka, some garmentmakers say that Chinese fabric suppliers are cheaper, faster and more reliable.

In March, a report by McKinsey, a consultancy, commissioned by DHL, a shipping and logistics firm, suggested that, in the absence of further reforms, the growth rate of India's textile exports would be no more than 8% a year. It reported a study comparing the number of men's shirts produced per hour and found that India's productivity was at 35% of American levels. China scores a much more impressive 55%. The overall productivity of India's textile industry was only 16% of America's.

Many reforms are promised by the Congress-led government that took power in May. On some—such as a sweeping tax reform—it is optimistic it can deliver. Others, however, especially labour-law reform, will be difficult for a party that relies for its parliamentary majority on the votes of communist parties. Kamal Nath, the commerce minister, says a manufacturer told him he had declined an order for 50,000 shirts because he could not risk taking on workers he could not let go. “We have to move from protection of employment to promotion of employment,” says Mr Nath, more in hope than expectation.

One other likely winner in the new regime is Pakistan. Its strengths are low labour costs, a raw-material base in both cotton and man-made fibres, and an estimated $4 billion in investment in the past four years. Because of its importance as an American ally, Pakistan has benefited from enlarged quotas in recent years. But in some market segments—such as bed linen and towels—it is seen as a good global competitor.

But what about the expected losers? Like athletes forced on to performance-enhancing substances who now struggle to compete on their own merits, they will suffer painful after-effects from quotas. In South Asia, Bangladesh, Nepal and Sri Lanka are all vulnerable. In Bangladesh, for example, the industry has grown from 400,000 people and 800 factories in 1990 to nearly 2m people and 4,000 factories now. Nine-tenths of the workers are women. Zaidi Sattar, an economist at the World Bank in Dhaka, estimates that 10m-12m people depend on the industry.

An IMF report published in June puts the potential loss to Bangladesh's exports from quota elimination at 25%. That, says Mr Sattar, is “on the pessimistic side”. But there are real worries. There is a debate about the garment industry's lack of “backward linkages”—its raw materials are all imported, putting a premium on labour costs, productivity and transport. Some want the government to help by subsidising the production of man-made fibres and fabrics. Upstream, textiles are a capital-intensive industry and capital is in short supply and expensive in Bangladesh, so taxpayer's money might be better spent on, say, roads.

Threads of life

You would have to be a very hard-hearted free-trader not to feel a pang for the threatened Bangladeshi garment worker. Like her counterparts in Sri Lanka and Nepal—and elsewhere—she already suffers from living in a country beset by political instability, and has to bear the additional burden of frequent cyclones and floods.

The effect of the quota eliminations may not, however, turn out to be as bad as some fear. The Goldman Sachs survey found that 86% of European buyers and all the American ones were already negotiating price cuts. Yet Bangladesh was second only to India among countries where buyers expected to increase procurement in 2005. It must be doing something right.

The survey also found that most buyers expect to buy from fewer countries than before. The trade is ever more dominated by a few giant retailers—such as Wal-Mart and J.C. Penney—whose purchasing decisions will help dictate the shape of the global industry. That is grim news for many of the less productive garment-manufacturing locations.

Yet Wal-Mart says that its global garment procurement in 2005 will be much the same as in 2004. There are a number of reasons to think that it may be some time before the full impact of the year-end cut-off is felt. First, countries have found their niches—Sri Lanka, for example, is strong in lingerie; it is one of Victoria's Secrets. Second, safeguards against surges of Chinese imports are likely to be invoked in both the EU and America for some products, leading to arguments at the WTO. That will extend the transition period. Change may not come as fast, or as brutally, as the pessimists fear. But remorselessly, the loose threads of the global textile industry are being tied up.

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America's financial markets

The Bush bounce

Nov 11th 2004 | NEW YORK
From The Economist print edition

Investors cheer the election, shrugging off higher interest rates and economic fears

Get article background

THE American stockmarket's verdict on the election was plain: hooray for George Bush. When early exit polls on November 2nd suggested that John Kerry would become president, equity prices dropped. They changed course abruptly once the true result emerged: according to a survey of 40 hedge funds by International Strategy & Investment, a research firm, these investors went from net short to net long as soon as the election results became clear.

A week later, the market had not given up its gains. A surprisingly good jobs report on November 5th, indicating that non-farm employment had risen by 337,000 in the previous month, did the market no harm at all. And share prices were never likely to be perturbed by the Federal Reserve's decision, on November 10th, to increase the federal funds rate by a quarter-point, to 2%. The Fed's plans had been clear long before, and the rise had been priced in. Indeed, several further increases are generally expected.

By and large, Mr Bush's re-election has been good news for companies that benefit from increased public and private spending, friendly government and low taxes—most companies, in other words. The gainers include department stores, health care and defence (see chart), along with heavy machinery, air freight and industrial metals. Stocks with large dividends also rose strongly, reflecting a belief that under Mr Bush taxes on capital will be lower than they might have been under Mr Kerry. Only two sectors have slipped. One is energy, perhaps because Mr Bush would allow more drilling in America and thus boost supply. The other is textiles, possibly because Mr Bush seems keener on free trade than Mr Kerry.

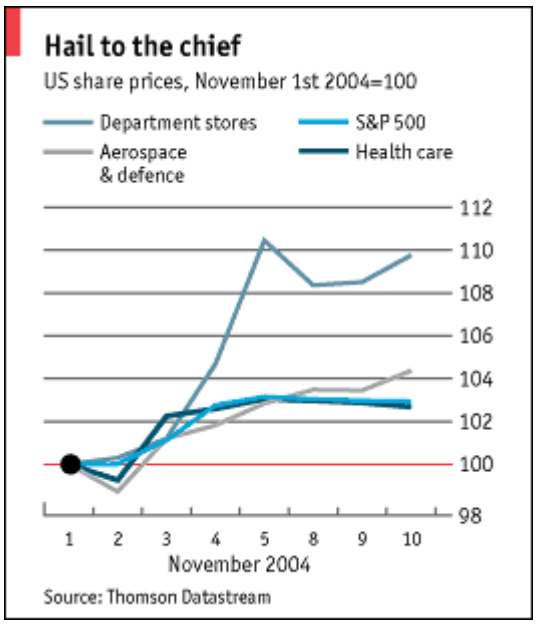
Furthermore, it could be that investors were quite happy with continuity. Despite a lot of gloomy talk—about rising oil and petrol prices, and the slow pick-up in employment as the economy has grown—the American economy is not in noticeably poor shape. Growth is pretty strong. Inflation is low, though showing some signs of rising. Unemployment, at 5.5%, is a little lower than when Bill Clinton was re-elected in 1996.

Corporate profits have risen by 75% over the past three years and profit margins are approaching their highest in three decades, according to Silvercrest Asset Management. Interest payments as a percentage of GDP have fallen back to the levels of the early 1980s, before junk bonds and highly leveraged

acquisitions became popular and made it easy for companies to pile up debts. Bond defaults are low. Small and mid-sized companies are in better shape than they have been in four years, says James Hance, vice-chairman of Bank of America. For the first time in years, there are signs that these companies' deposits are beginning to fall. This might be a sign that demand for commercial and industrial loans, which has stagnated in the past few years, is about to increase.

There is more. Although the Bush administration is not perceived to be especially close to Wall Street—unlike Mr Clinton, Mr Bush has not yet appointed a treasury secretary from a financial firm—it is seen as a friend of business. Thus the election relieved the market's concerns that new taxes would be imposed. Besides the Republicans' successful defence of the White House and gains in Congress, judges backed by business groups were elected in several states. Initiatives to curtail litigation were passed in California, Florida, Nevada and Wyoming. That may help businesses facing class-action lawsuits over asbestos, medical malpractice and behaviour in securities markets. President Bush wants still more tort reform. President Kerry might have looked more threatening, with John Edwards, a former trial lawyer, as his vice-president.

However, by no means is everything rosy for the stockmarket, which has had a curious year. Although the economy has been doing decently and profits for the companies making up the S&P 500 are likely to be 20% higher this year than last, on the eve of the election share prices stood roughly where they had on January 1st, having surrendered all the gains they had made earlier in the year. Maybe uncertainty about the election had something to do with this.



The cloud around the silver lining

Looking ahead, the sinking dollar (see article) should be a fillip to American exporters, but it will also add to inflationary pressures. Household savings are low: if these have to rise, then consumers will spend less. Corporate earnings are still growing strongly, but the pace is fading. Profit growth of 10% next year, which many analysts expect, sounds brisk but is only half this year's rate; the year after, it may be slower still. If the job market is tightening at last, then this will push up wage costs. Worse, America has a huge government budget deficit that can only be reduced by extraordinary economic growth, higher taxes or spending cuts. Worse still, Mr Bush shows little inclination to plug it: many on Wall Street hoped for a Kerry victory if only because a split between Congress and the executive might have halted spending growth.

This caution about the economy is visible in the niggardly yields on Treasury bonds. Despite the Bush victory—possibly meaning more government borrowing than a Kerry presidency—the latest, bullish jobs report and the upward path that the Fed appears to be setting for short-term interest rates, the ten-year note still yields a mere 4.2%, the stuff of fantasy for most of the past four decades. Though this spells bliss for borrowers, it may also signal that bond markets are gloomy about growth.

And after the markets' brief burst of post-election euphoria, they will have to look ahead to what Mr Bush might do in his second term. Several initiatives he intends to pursue will have a direct impact on the public markets, notably the creation of some form of individual retirement accounts in place of Social Security and a broad revision of the tax code. None of this will be easy nor perhaps even feasible. Making it all a bit more difficult will be the likelihood that Alan Greenspan, chairman of the Federal Reserve, will finally retire at the end of his term in two years. The name of his replacement may mean as much to the markets as did the American people's verdict on November 2nd.

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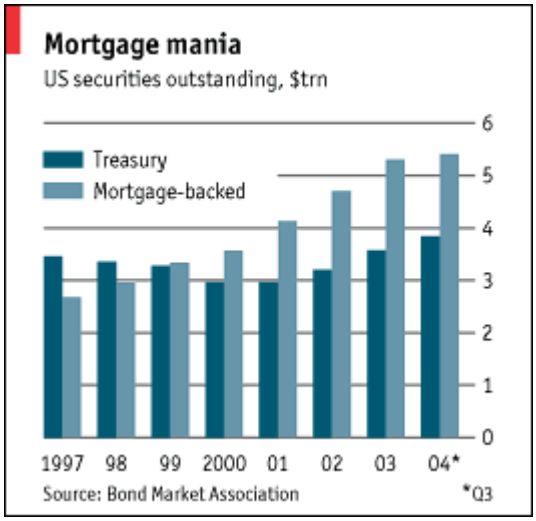
American banks

Insecurities

Nov 11th 2004 | NEW YORK
From The Economist print edition

Higher interest rates may mean harder times for America's banks

Get article background



MANY things in life are unexpected. The upward nudge that the Federal Reserve gave to American interest rates on November 10th was not one of them. Further increases in rates look almost certain. Less predictable, however, is the speed with which they will come.

How far and how fast the Fed tightens policy could have important implications for the boom (some say bubble) in American house prices that record low interest rates have fuelled over the past four years. It might also matter a great deal to America's banks, which have made plenty of money in recent years from the roaring mortgage market. “Never have rates been so low for so long as they have in this cycle,” says Nancy Bush of NAB Research in New Jersey. “The concern is that the mortgage boom has really distorted expectations for the bank sector's growth.” Banks, she points out, have profited in many ways from the boom—mortgage lending and refinancing, home-equity loans and gains on the sale of banks' mortgage portfolios—all of which are vulnerable to a housing-market slowdown.

Then there are mortgage-backed securities (MBSs)—bonds comprising bundles of mortgages—which have also helped to boost banks' profits. At the end of June, $5.4 trillion-worth of these securities were outstanding, dwarfing the $3.8 trillion Treasury market (see chart), even though issues of MBSs have slowed recently. According to the Office of the Comptroller of the Currency, one of America's many bank regulators, mortgage-related assets, which include mortgages as well as MBSs, now make up 28% of American commercial banks' assets, compared with just 10% in 1987. They account for more than 90% of the total earning assets of Golden West Financial, a Californian bank, and almost half of those of the American subsidiary of HSBC, a huge British bank.

With interest rates on the rise, the size of banks' mortgage-related assets could pose a problem. This is much less true of mortgages with variable interest rates—Golden West, for example, is almost wholly an adjustable-rate lender—than of MBSs. These alone make up about half of the earning assets of Commerce Bancorp, a fast-expanding New Jersey bank, and Mellon Financial, a biggish lender, according to Standard & Poor's (S&P), a rating agency. At Fifth Third, another fast grower, and the American arm of ABNAMRO, a Dutch bank, they make up a quarter.

Banks' holdings of MBSs have swollen as a result of the rapid growth of American bank deposits. This, in turn, was a product of the refinancing of mortgages at cheap rates, which put money into home-owners' pockets. They chose to put this cash into banks rather than the choppy stockmarket or low-yielding bonds. Banks opened hundreds of branches to chase deposits. According to James Callahan of Morningstar, an investment-research firm, the average bank has seen annual deposit growth of almost 10% in recent years, well above the long-term average.

Normally, these deposits would be recycled into loans to companies. But commercial lending has been weak since the technology bubble burst. So deposit-rich banks have put the money they have attracted into MBSs, which yield more than Treasuries but are considered to be almost as safe. In part, this is because many of them are issued by Fannie Mae and Freddie Mac, America's giant mortgage companies,

which the markets treat as if they had a government guarantee.

One problem the banks now face is that the value of MBSs, like that of Treasuries, falls as interest rates rise. Worse, MBSs also have “extension risk”. Unlike most bonds, MBSs have no fixed maturity. People can prepay their mortgages if they choose, as they tend to when interest rates are low. When they rise, consumers prolong payments and the duration of these securities lengthens. This makes their value much more sensitive to rising rates.

This need not matter if banks have funded their investments carefully and hedged their exposure. The risk, says S&P, is that some banks have used shorter-term deposits to invest in long-term MBSs that are now being extended. This year, some banks have already seen unrealised gains on their holdings of MBSs turn into unrealised losses.

As the value of their bond portfolios falls, some banks may well choose to offload securities. Banknorth, based in Maine, has this year sold $1.2 billion-worth of Treasuries, taking a pre-tax charge of $80.8m. But many banks may prefer to avoid realising similar losses on their mortgage-related portfolios. They will be even less willing to take these, says Don Ullmann of Keefe, Bruyette & Woods, an investment bank, without an offsetting pick-up in commercial lending.

Although there are some signs of this (see article), corporate lending is still tepid. If it stays that way, some banks may find themselves in a bind. With the mortgage boom slowing, American consumers are already fully laden with debt and the value of MBSs balances is declining. Good luck.

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Sustainability

Does it add value?

Nov 11th 2004
From The Economist print edition

Blood and Gore set out to prove that non-financial measures matter

AP

Thinking up sustainable measures

AT A time when he could conceivably have been preparing for a second term in the White House, Al Gore was in London this week to launch a new investment-management firm. The unsuccessful Democratic candidate for the American presidency in 2000 is now chairman of Generation Investment Management, which says it will, when fully open for business in the new year, "integrate rigorous traditional fundamental equity analysis with sustainability research to create a new approach to long-term investing".

The genesis of this bold idea was a meeting between Mr Gore and David Blood, a former chief executive of Goldman Sachs Asset Management and now Generation's managing partner. The two men complemented each other in more than their surnames. As vice-president, Mr Gore was the main cheerleader for sustainable development during Bill Clinton's presidency, and wrote "Earth in the Balance", a book which established his environmental credentials; Mr Blood was a fund manager who saw a demand for long-term investment to take into account his belief that "social, environmental and geopolitical issues can materially impact a company's ability to sustain returns." Generation combines Mr Gore's political savvy with Mr Blood's market instinct.

One challenge for such an organisation is to find a credible and consistent way of connecting these factors to long-term financial performance. The state of the art is not well advanced. Last week's ranking of companies' non-financial reports by SustainAbility, a consultancy, the United Nations Environment Programme and Standard & Poor's, a credit-rating agency (see *The Economist*, November 6th), demonstrated what a hotchpotch of different methods are used by those companies which are making an attempt to "account" for social and environmental factors. Generation will devote 5% of its profits to funding an organisation dedicated to finding better ways to integrate measures of sustainability with traditional financial analysis. "It is time," says Mr Gore, "to do this in a more effective way." Indeed.

Long-term investors are not the only ones looking for improvements in the field. A recent survey by the Economist Intelligence Unit, a sister company of *The Economist*, and Deloitte, a big accounting firm, asked 249 executives and directors of large companies around the world about the monitoring of their businesses' non-financial performance. Almost three-quarters of the respondents said that companies are under increasing pressure to come up with non-financial measures; they also said that these are mediocre or poor, when they are available. Only 9% said they felt that such measures helped the capital markets to make an "appropriate valuation" of their company.

The factors that sustain long-term corporate returns are but vaguely understood. Some research suggests a correlation between a company's stance on environmental and social issues and its long-term performance, but none yet shows a causal relationship between them. Until that can be established, investors will be left wondering whether sustainability analysis is more than a mere curiosity.

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About sponsorship

Cazenove

Last of the line

Nov 11th 2004
From The Economist print edition

A deal between J.P. Morgan and a small British bank

Philip joins forces with Pierpont

TO READ some of the press comments, Cazenove, a small British investment bank, is a uniquely wonderful institution that displays all of the virtues of the City of old and none of its vices. Its chairman, David Mayhew, is routinely described as the City's most powerful banker, and its client list is the envy of its rivals. In the past few months speculation about Cazenove has been especially fevered because the bank has been trying to flog itself to many of the world's biggest financial institutions. On November 4th it at last came to a deal to set up a joint venture with one of them: J.P. Morgan Chase.

The acres of coverage that the deal has received is inversely proportional to its importance. Why the huge interest? One reason is that so few of the City's intermediaries are now British-owned, but the more likely one is that Cazenove is beloved by toffs up and down the country.

The deal is, in fact, tiddly. Chase bought Robert Fleming, another British investment bank, for £4.9 billion ($7.7 billion) in April 2000, and later that year bought J.P. Morgan itself for $36 billion. Earlier this year, the combined J.P. Morgan Chase bought Bank One for $58 billion. It is now paying, ahem, £110m to Cazenove for a half share of the investment-banking joint venture and putting in £50m of capital and 70 of its staff. The new firm, which is to be called J.P. Morgan Cazenove, will employ 820 people. J.P. Morgan currently employs 17,000 in its investment-banking operations worldwide.

After five years, J.P. Morgan will have the right to buy Cazenove out, and the latter will have the right to sell to the bank, at a price to be set independently. Though there are a few penalties involved, this means that it is almost certain that the American giant will end up with the lot.

That should be a mildly toothsome prospect: Cazenove has lots of close relationships with British companies. However, this is mainly because it appears to demand so little from its clients. Though it is a corporate broker (a nebulous role that involves giving a bit of advice to companies about their relations with shareholders) to 43 of Britain's top 100 companies, it gets precious little money for this. Nor for much else, come to that. It made net profits of £26.3m last year and £13.4m the year before. Many hedge funds have made more.

J.P. Morgan thinks it can milk those companies a bit more without alienating them (as you might imagine, it says that it is very client-focused itself). It also likes Cazenove's equity-broking and corporate-finance businesses, though it thinks both will be more profitable if they have more things to offer. Indeed, says J.P. Morgan, all of Cazenove's clients are delighted about that prospect: blue-blooded it might be, but the British firm has no balance-sheet clout to offer to corporate clients and does nothing at all in debt. Each is something of a handicap for an investment bank.

Slamming together the two banks' businesses will probably push it to the top of the investment-banking tree in Britain. That will make it a good deal for J.P. Morgan, but also for Cazenove's shareholders, most of whom are its employees. As well as the £110m that J.P. Morgan is paying upfront, they will see another £230m of capital released from the investment-banking business and the potential for a lot more in the future. They will also retain control of Cazenove's asset-management and private-equity businesses, though neither of these is big.

For Mr Mayhew, this deal looks a triumph of salesmanship. Founded by Philip Cazenove 181 years ago, Cazenove was a partnership until it incorporated in 2001, but withdrew a flotation because of the bear market. For a bank that advises companies on such matters, that did not look good. But this latest deal looks very good indeed, and Mr Mayhew's reputation, if not the bank's, thoroughly deserved.

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German investment banking

Beating a retreat

Nov 11th 2004 | FRANKFURT
From The Economist print edition

Making money at home may be no easier than abroad

HOME-GROWN investment banks, never that impressive in Germany, are losing out increasingly to a handful of foreign invaders. Last month this was acutely evident when Kreditanstalt für Wiederaufbau, the state development bank, auctioned a large block of Deutsche Telekom shares exclusively through foreign banks, to the fury of the locals. This week, Commerzbank, the country's third-largest listed bank, announced big layoffs in investment banking, where it made an operating loss of €171m ($210m) last quarter. It is closing its Tokyo operation, halving its headcount in London and cutting back severely in New York. Commerzbank says it will concentrate on its domestic market from now on.

Foreigners in Frankfurt

Investment banks' share of German market in: year to date, %

	mergers & acquisitions	bookrunning in: equity markets	bookrunning in: debt* markets
J.P. Morgan	20.9	18.2	4.7
Deutsche Bank	20.7	12.8	10.5
Goldman Sachs	20.3	0.0	3.9
Dresdner Kleinwort Wasserstein	18.3	9.0	5.8
Morgan Stanley	17.8	20.1	5.6
Lazard	13.2	0.0	0.0
Credit Suisse	11.8	2.4	4.8
Sal Oppenheim	11.0	0.0	0.0
UBS	10.5	2.7	0.0
Rothschild	7.9	0.0	0.0
Citigroup	4.6	17.4	7.2

Source: Dealogic *Excludes asset-backed securities

That leaves only two German institutions, Deutsche Bank and Dresdner Bank, with pretensions to international investment banking. Even they are focusing more and more on their home turf. The reason is that they are being beaten in their former private hunting ground by the likes of J.P. Morgan, Morgan Stanley and Goldman Sachs. These banks have been active in Germany since at least the early 1990s. But the complexity of financing techniques, the global integration of markets and the span of investors have all worked in their favour. Unfortunately for German banks, big and even middle-sized German companies increasingly demand that one of the five or six top global investment banks be involved in their deals in the equity or debt markets. The league tables tell the story.

This is happening at a time when optimists predict a big increase in demand for investment-banking services in Germany in the next few years. Privatisations worth an estimated €50 billion are in the pipeline. Corporate restructuring and spin-offs should generate €1.7 billion a year in mergers and acquisitions (M&A) fees. Public-sector banks are changing their funding patterns as they lose their state guarantees and will require imaginative refinancing. There are €50 billion-75 billion of poorly performing loans, mostly in property, to be repackaged and sold. Private-equity firms and hedge funds are hungry for underpriced German assets, and want leveraged loans.

These tasks demand a certain level of staffing and skill, which not many banks can supply. Although a handful of boutiques, among them Lazard and Rothschild, do well as pure advisers, the bulk of this business will probably go to the top global players. Accordingly, two investment banks which reduced their German operations at the end of the 1990s, CSFB and Merrill Lynch, are recruiting again. Since the second quarter of the year CSFB has hired experts in leveraged finance, debt trading, M&A, proprietary trading and property finance, mostly from Dresdner and Commerzbank. The nonsense of promising new recruits guaranteed bonuses for up to three years has started again. Expectations are high. But as Hans Jörg Schüttler, head of German investment banking at Morgan Stanley, notes: “The sentiment has always been more positive than the actual results.”

Deutsche Bank is the only indigenous bank likely to hold its own. It excels in some investment-banking disciplines. But it has problems too: many employees wonder what kind of bank they work for (German, global or both?) and it has lost faith among its German clients. Jürgen Fitschen, head of a new management committee for Germany, declared recently: “Even those clients who criticise us say they want a long-term relationship.” However, Deutsche can no longer bet that the relationship will be exclusive.

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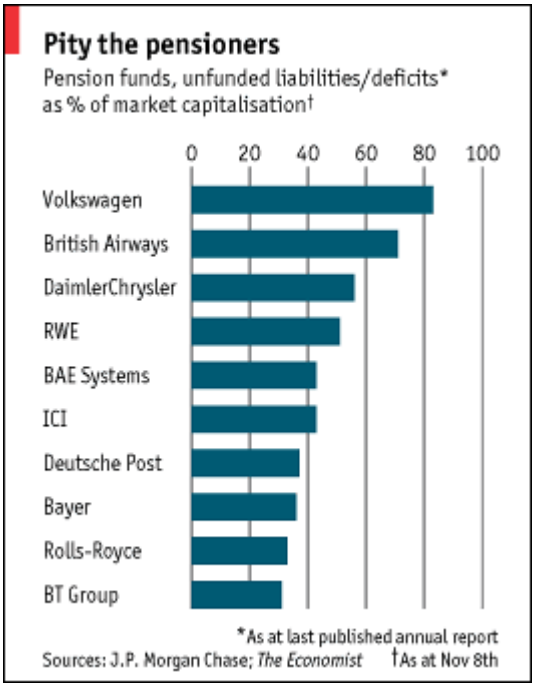
European pension accounting

Painful

Nov 11th 2004
From The Economist print edition

The picture is bleak. New accounting standards could make it bleaker

LIFE, not death, may be the final accounting for Europe's harried executives. Next year, the way they tally assets and liabilities in their companies' pension plans is due to change when international accounting standards take effect for listed firms. The new rules will make it (a bit) harder to pretend that big deficits do not exist, and easier for investors to compare pension-financing across companies.



Companies are bracing themselves. Already, defined-benefit pensions—in which employees are promised a certain amount upon retirement—are in big trouble. The stockmarket slump has hurt investment returns; meanwhile, retirees keep living longer and low interest rates have pushed up the present value of liabilities. British Airways' pension deficit is around 70% of its market capitalisation, with other worthies such as Rolls-Royce and BT not far behind, according to J.P. Morgan Chase (see chart).

On the continent, the picture is varied. Germany's Volkswagen, DaimlerChrysler and Deutsche Post all have hefty unfunded liabilities. German companies look worst, because many use pay-as-you-go schemes, in which contributions are paid out immediately to today's pensioners rather than (as in Britain) invested. The meticulous Dutch usually fund their pensions fully. In France and Italy the state shoulders much of the pension burden; other French schemes are pay-as-you-go.

Whereas a majority of continental companies with huge pension schemes already use international financial-reporting standards or similar American ones, lots of big British companies are in the process of switching standards. So the new accounting rules will affect the Brits most, says J.P. Morgan: many are likely to put their full pension deficits on their balance sheets next year for the first time, although they already disclose enough information for investors to do the maths themselves.

The new numbers may be a jolt for both investors and pensioners, for two reasons. First is pension liabilities: under the new rules, a company's future obligations will be calculated using the yield on high-quality corporate bonds. Because this is a smaller number than many companies used before, the present value of the obligations will be higher. (Some argue that the discount rate should be lower still.)

The second reason is on the asset side. Companies habitually smooth investment returns, on the theory that the actual figures would be too volatile for investors and analysts to bear. Under the new rules, companies will be able to choose between smoothed and actual returns. They are now scrambling to decide what to do.

Eventually, international rules will probably be tightened to require the actual, volatile numbers on balance sheets. Britain is slightly ahead on this, since its own rules ensure more fair-value reporting, although some important requirements will not apply to non-listed companies until next year.

One weakness of the new rules, argues Keith Jecks of ABNAMRO, is that they do not require companies to disclose the amount needed to wind up their pension plans. “Discontinuance” is increasingly an issue in Britain, where two recent takeover attempts failed partly owing to bidders' fears of giant, ill-tallied

pension liabilities.

Even so, the new rules should give a more standardised, grimmer picture of companies' pension plans. Although some firms may dip into profits to plug newly exposed gaps, many more will continue the trend of junking defined-benefit schemes altogether. Lots of FTSE 100 companies have closed such schemes to new employees, and are switching to defined-contribution plans, which make no promises to pensioners.

Mr Jecks notes that current employees often comprise only one-fifth of a pension scheme's members; the rest are retired or working elsewhere. Pension finances may look even worse in six months, when Britain's actuaries produce a study on longevity. Future centenarians would be wise to find alternative ways of saving.

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Economic growth

Dancing in step

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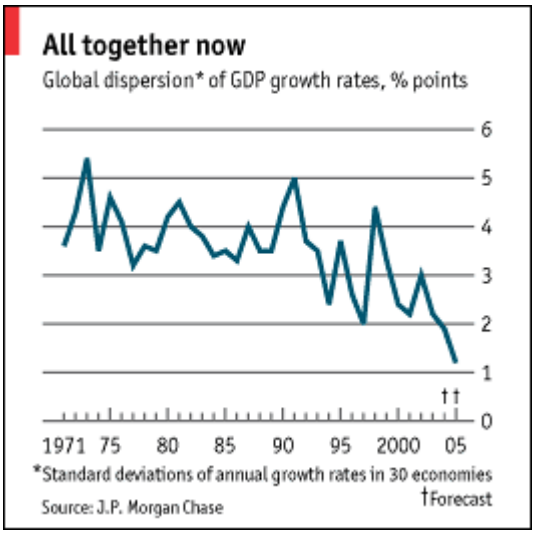
From The Economist print edition



The world's economies are more synchronised than ever before

THIS is proving to be a vintage year for the global economy. Not only is world GDP growing at its fastest rate for almost 30 years, but growth is also being more evenly shared. Each week *The Economist* tracks the economic fortunes of 55 countries (see our indicators). For the first time since at least 1980, all 55 economies are growing. Hitherto at least one has been in recession.

Indeed, growth rates around the world are currently more synchronised than ever, according to the J.P. Morgan global growth dispersion index (see chart). This is based on the standard deviations of annual growth rates of 30 countries for which GDP figures are available since 1971. Over the past few years the degree of growth dispersion has fallen to half that in the 1970s. Based on the bank's forecasts for 2005, growth will become even more synchronised next year, as American and Asian economies slow down and some European countries perk up.

Two forces lie behind all this. First, in recent years many economies have been driven by common factors: the boom and bust in information-technology shares, followed by unusually loose monetary policies almost everywhere. Second, countries' business cycles are also becoming more closely correlated, as greater integration through trade, investment and financial markets causes economies to move more closely in step. This trend may be bad news for economists: in future investment banks (and magazines) may need fewer of them to keep tabs on the world economy.

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Economics focus

Checking the depth gauge

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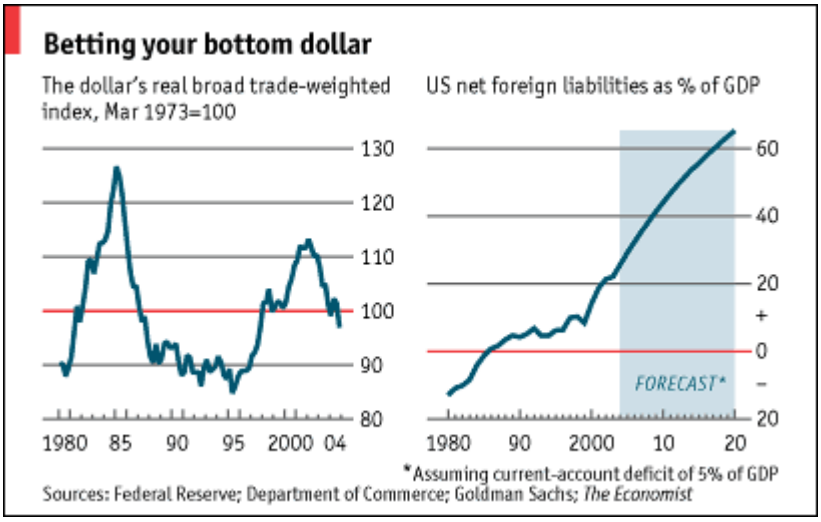
How low might the dollar sink?



Get article background

AS THE dollar hit another new low against the euro, briefly breaching $1.30 on November 10th, an increasing number of economists are asking how far the greenback might fall and how its slide will affect the world economy. One of the most alarming answers comes from Paul Volcker, Alan Greenspan's immediate predecessor as chairman of the Federal Reserve. He recently said that he thought there was a 75% chance of a currency crisis in the United States within five years.

It is easy to see how this might happen. America's current-account deficit is running at a record 6% of GDP this year, and on existing policies it will continue to widen. America's net foreign liabilities are already 23% of GDP, and economists at Goldman Sachs calculate that this figure will reach more than 60% by 2020, even if the current-account deficit stabilises at 5% of GDP (see chart). Other countries, such as Australia and New Zealand, have sustained large external deficits for long periods, but America's borrowing is much bigger in absolute terms. It is eating up around 75% of the excess saving of Japan, China, Germany and other countries with current-account surpluses. If the dollar did not have the advantage of being the world's main reserve currency, America would already be in serious trouble. Instead, the willingness of Asian central banks to lend to the United States has allowed its deficit to keep growing for longer. Nevertheless, the deficit is unsustainable: sooner or later it will need to shrink, and that will involve a cheaper dollar.

A new paper* by Maurice Obstfeld, an economist at the University of California, Berkeley, and Kenneth Rogoff, of Harvard, a former head of research at the International Monetary Fund, predicts that the dollar will fall by another 20% in real trade-weighted terms even if America's external deficit unwinds gradually. If the adjustment is more abrupt, the dollar will dive by more than 40%.

Many economists try to estimate how much the dollar needs to fall in order to eliminate or at least to reduce the current-account deficit. But Mr Obstfeld and Mr Rogoff argue that such analysis is flawed. America's current-account deficit reflects inadequate domestic saving. Cutting it therefore requires that American saving rises or that demand in the rest of the world increases. A fall in the dollar would be a by-product of this adjustment. But without an increase in saving, even a big fall in the dollar would make only a small dent in America's current-account deficit.

The two economists assume that the current-account deficit shrinks as a result either of increased saving by American households (because, for instance, the country's house-price boom ends) or of a strengthening of demand in Asia and Europe. Then, using a model of the global economy, they focus on the changes in relative prices of traded and non-traded goods needed to ensure that demand matches supply in domestic product markets as the current-account deficit narrows.

According to conventional wisdom, a weaker dollar reduces the trade deficit by boosting American exports. That is true, but Mr Obstfeld and Mr Rogoff argue that the main pressure for a fall in the dollar comes instead from the need to encourage Americans to consume fewer traded goods (ie, both imports and goods that could be exported) and to buy more non-traded goods and services. If the current-account deficit is reduced through an increase in household saving, spending on non-traded as well as traded goods will drop. To maintain equilibrium in domestic markets and to prevent a rise in unemployment, the consumption of non-traded goods needs to rise relative to that of traded goods. This in turn requires a decrease in the relative price of non-traded goods. This means that the dollar's real exchange rate must fall.

From this way of viewing the likely fall in the dollar, the substitution of American for foreign traded goods is less important than of non-traded for traded goods. But because traded goods account for only around 25% of America's GDP, the current-account deficit of 5-6% of GDP amounts to an enormous 20-25% of traded-goods production. Thus closing the external deficit while maintaining domestic equilibrium requires a big change in the relative price of non-traded versus traded goods, and therefore in the exchange rate.

An echo of the seventies?

The real question is not whether the dollar needs to fall, but how drastic the economic effects of its fall will be. In the mid-1980s, the greenback's trade-weighted value declined by 40% with few ill-effects in America. The world economy absorbed the shock reasonably well. Unfortunately, the authors see more parallels today with the dollar's collapse in the 1970s, when the Bretton Woods system broke down. Like today, that was a time of large budget deficits, loose monetary policy and rising oil prices, and America faced open-ended costs to pay for a war. Today, the combined costs of fighting in Iraq and maintaining security at home could easily match the cumulative 12% of GDP that the Vietnam war cost. There is therefore a risk that the global economic consequences might be as severe as those which followed the demise of Bretton Woods, with higher interest rates and a drop in global output.

If Mr Obstfeld's and Mr Rogoff's gloomier prediction turns out to be correct and the dollar falls by 40% or more, then this would, in effect, amount to the biggest “default” in history. This would not, of course, be a conventional failure to service debt, but could be viewed as default by stealth. America borrows from others largely in its own currency, so by letting the dollar drop it would wipe trillions off the value of foreigners' dollar assets. In such circumstances, the risk of a financial crisis is not negligible. As Mr Rogoff puts it: “The world is set to jump off the top of a waterfall without knowing how deep the water is below.”

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* “The Unsustainable US Current Account Position Revisited”. NBER working paper 10869, October 2004

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Climate change

A canary in the coal mine

Nov 11th 2004
From The Economist print edition

Science Photo Library

The Arctic seems to be getting warmer. So what?

Get article background

“CLIMATE change in the Arctic is a reality now!” So insists Robert Corell, an oceanographer with the American Meteorological Society. Wild-eyed proclamations are all too common when it comes to global warming, but in this case his assertion seems well founded.

Dr Corell heads a team of some 300 scientists who have spent the past four years investigating the matter in a process known as the Arctic Climate Impact Assessment (ACIA). The group, drawn from the eight countries with territories inside the Arctic Circle, has just issued a report called “Impacts of a Warming Arctic”, a lengthy summary of the principal scientific findings. A second report, which will sketch out recommended policies, is due out in a few weeks. A third, far heftier tome detailing all the scientific findings will not come out for some months yet.

Already, though, the ACIA has made a splash. One reason is the inevitable wrangling over policy recommendations. News reports have suggested that the Bush administration has tried to suppress signs of support in the second, as yet unreleased, report, for the UN's Kyoto protocol or other mandatory policies for the control of greenhouse-gas emissions. But even setting politics aside, this week's scientific report has still created a stir with its bold assessment of polar warming.

At first sight, its conclusions are not so surprising. After all, scientists have long suspected that several factors lead to greater temperature swings at the poles than elsewhere on the planet. One is albedo—the posh scientific name for how much sunlight is absorbed by a planet's surface, and how much is reflected. Most of the polar regions are covered in snow and ice, which are much more reflective than soil or ocean. If that snow melts, the exposure of dark earth (which absorbs heat) acts as a feedback loop that accelerates warming. A second factor that makes the poles special is that the atmosphere is thinner there than at the equator, and so less energy is required to warm it up. A third factor is that less solar energy is lost in evaporation at the frigid poles than in the steamy tropics.

And yet the language of this week's report is still eye-catching: “the Arctic is now experiencing some of the most rapid and severe climate change on Earth.” The last authoritative assessment of the topic was done by the UN's Intergovernmental Panel on Climate Change (IPCC) in 2001. That report made headlines by predicting a rise in sea level of between 10cm (four inches) and 90cm, and a temperature rise of between 1.4°C and 5.8°C over this century. However, its authors did not feel confident in predicting either rapid polar warming or the speedy demise of the Greenland ice sheet. Pointing to evidence gathered since the IPCC report, this week's report suggests trouble lies ahead.

Hot on top

The ACIA reckons that in recent decades average temperatures have increased almost twice as fast in the Arctic as they have in the rest of the world. Sceptics argue that there are places, such as the high latitudes of the Greenland ice sheet and some buoys at sea, where temperatures seem to have fallen. On the other hand, there are also places, such as parts of Alaska, where they have risen far faster than average. Robin Bell, a geophysicist at Columbia University who was not involved in the report's compilation, believes that such conflicting local trends point to the value of the international, interdisciplinary approach of this week's report. As he observes, “climate change, like the weather, can be patchy and you can get fooled unless you look at the whole picture.”

And there is other evidence of warming to bolster the ACIA's case. For example, the report documents the widespread melting of glaciers and of sea ice, a trend already making life miserable for the polar bears and seals that depend on that ice. It also notes a shortening of the snow season. The most worrying finding, however, is evidence—still preliminary—that the Greenland ice sheet may be melting faster than previously thought.

That points to one reason the world should pay attention to this week's report. Like a canary in a coal mine, the hyper-sensitive polar regions may well experience the full force of global warming before the rest of the planet does. However, there is a second and bigger reason to pay attention. An unexpectedly rapid warming of the Arctic could also lead directly to greater climate change elsewhere on the planet.

Arctic warming may influence the global climate in several ways. One is that huge amounts of methane, a particularly potent greenhouse gas, are stored in the permafrost of the tundra. Although a thaw would allow forests to invade the tundra, which would tend to ameliorate any global warming that is going on (since trees capture carbon dioxide, the greenhouse gas most talked about in the context of climate change), a melting of the permafrost might also lead to a lot of trapped methane being released into the atmosphere, more than offsetting the cooling effects of the new forests.

Another worry is that Arctic warming will influence ocean circulation in ways that are not fully understood. One link in the chain is the salinity of sea water, which is decreasing in the north Atlantic thanks to an increase in glacial meltwaters. Because fresh water and salt water have different densities, this “freshening” of the ocean could change circulation patterns. The most celebrated risk is to the mid-Atlantic Conveyor Belt, a current which brings warm water from the tropics to north-western Europe, and which is responsible for that region's unusually mild winters. Some of the ACIA's experts are fretting over evidence of reduced density and salinity in waters near the Arctic that could adversely affect this current.

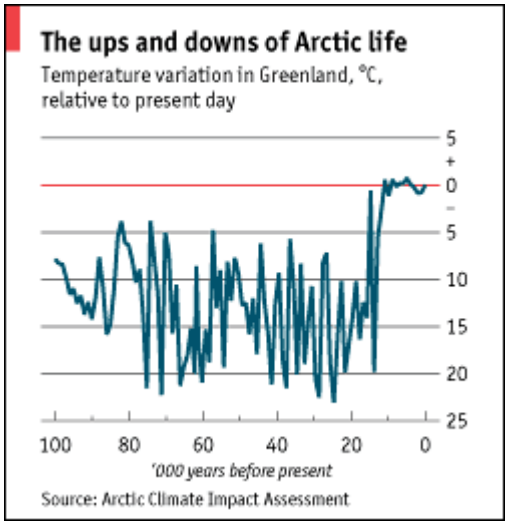
The biggest popular worry, though, is that melting Arctic ice could lead to a dramatic rise in sea level. Here, a few caveats are needed. For a start, much of the ice in the Arctic is floating in the sea already. Archimedes's principle shows that the melting of this ice will make no immediate difference to the sea's level, although it would change its albedo. Second, if land ice, such as that covering Greenland, does melt in large quantities, the process will take centuries. And third, although the experts are indeed worried that global warming might cause the oceans to rise, the main way they believe this will happen is by thermal expansion of the water itself.

Nevertheless, there is some cause for nervousness. As the ACIA researchers document, there are signs that the massive Greenland ice sheet might be melting more rapidly than was thought a few years ago. Cracks in the sheet appear to be allowing melt water to trickle to its base, explains Michael Oppenheimer, a climatologist at Princeton University who was not one of the report's authors. That water may act as a lubricant, speeding up the sheet's movement into the sea. If the entire sheet melted, the sea might rise by 6-7 metres. While acknowledging that disintegration this century is still an unlikely outcome, Dr Oppenheimer argues that the evidence of the past few years suggests it is more likely to happen over the next few centuries if the world does not reduce emissions of greenhouse gases. He worries that an accelerating Arctic warming trend may yet push the ice melt beyond an “irreversible on/off switch”.

Keeping a cool head

That is scary stuff, but some scientists remain unimpressed. Patrick Michaels, a climatologist at the University of Virginia, complains about the ACIA's data selection, which he believes may have produced evidence of “spurious warming”. He also points out,

in a new book*, that even if Arctic temperatures are rising, that need not lead directly to the ice melting. As he puts it, “Under global warming, Greenland's ice indeed might grow, especially if the warming occurs mostly in winter. After all, warming the air ten degrees when the temperature is dozens of degrees below freezing is likely to increase snowfall, since warmer air is generally moister and precipitates more water.”



Nils-Axel Morner, a Swedish climate expert based at Stockholm University, points out that observed rises in sea levels have not matched the IPCC's forecasts. Since this week's report relies on many such IPCC assumptions, he concludes it must be wrong. Others acknowledge that there is a warming trend in the Arctic, but insist that the cause is natural variability and not the burning of fossil fuels. Such folk point to the extraordinarily volatile history of Arctic temperatures. These varied, often suddenly, long before sport-utility vehicles were invented (see chart). However, the chart also shows that the past few millennia have been a period of unusual stability in the Arctic. It is just possible that the current period of warming could tip the delicate Arctic climate system out of balance, and so drag the rest of the planet with it.

Not everybody wants to hear a story like that. But what people truly believe is happening can be seen in their actions better than in their words. One of the report's most confident predictions is that the break-up of Arctic ice will open the region to long-distance shipping and, ironically, to drilling for oil and gas. It is surely no coincidence, then, that the Danish government, which controls Greenland, has just declared its intention to claim the mineral rights under the North Pole. It, at least, clearly believes that the Arctic ocean may soon be ice-free.

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*“Meltdown”, by Patrick Michaels. Cato Institute. $24.95.

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Optical tweezers

Seeds of change

Nov 11th 2004
From The Economist print edition

Male and female sperm can be sorted using lasers

ONE of the most useful pieces of equipment in science fiction is the tractor beam. This hypothetical device can be used for grasping hold of pieces of cargo, small spaceships and even asteroids without actually touching them. Pure fantasy, of course. But only because of the size of the things being moved. For, at the scale of molecules, or even living cells, scientists have been using tractor beams for years.

The beams in question are lasers. And given the size of the objects being moved, they have become known as optical tweezers. But, cunning though they are, they have been able to move only one thing at a time—which is fine for research, but not much use commercially. That is about to change, though, for a Chicago-based firm called Arryx has found a way to control thousands of these tweezers simultaneously. It thinks the technology has big commercial possibilities, from cleaning blood to building computer memories. But the first application is particularly appropriate to a firm from a city built on the cattle industry: sorting bull semen.

An optical tweezer works because a focused laser beam exerts a small force that is able to trap tiny particles at the beam's centre. Arryx's trick is to split a single beam into thousands of daughter beams by passing it through a computer-controlled liquid-crystal display. The display acts as a diffraction grating (diffraction is a well-established technique for splitting light beams), and because the grating is merely an image, both it and the paths of the daughter-beams it generates can be manipulated at will.

Sorting semen is an ideal task for such a device. Dairy farmers want cows, rather than bulls, and so would like to sort sperm containing X-chromosomes (which will produce daughters) from those with Y-chromosomes (which will produce sons). Though Lewis Gruber, Arryx's boss, is cagey about the details of how the sorting works, it probably depends on the fact that sperm with X-chromosomes are heavier than those with Ys, and thus respond differently in a beam. And having sorted the sperm by sex, it is an easy matter to stun the males with a blast of particularly intense light, and then remove them.

Dr Gruber expects to have a commercial sperm-sorter ready next year, and Arryx has already signed a deal to deploy it with a British dairy. In the past few weeks, the firm has also announced a partnership with a company called Haemonetics, of Braintree, Massachusetts, to develop a system that can sort blood cells in a similar way. This will allow the red cells, white cells and platelets, which have different clinical uses, to be separated. It will also remove bacteria and viruses from blood, both reducing the risks associated with transfusion and increasing the pool of potential blood donors.

Further into the future, optical tweezers might offer a way of making objects—such as computer memories—whose components are but a few nanometres (billionths of a metre) across. At the moment, memory chips are made by laying down strata of different chemicals on a silicon base, and then carving canyons through the layers in order to separate the individual components. It works, but it is clumsy. If it were possible to move the components around using optical tweezers, and put them directly on to a base, that would open up a completely different approach to the problem and might, ultimately, result in a new manufacturing technology.

It has to be said that this is a long shot. It would involve keeping track of millions—possibly billions—of beams, rather than mere thousands. But it could just be the seed of a good idea.

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3D television

Out of this world

Nov 11th 2004
From The Economist print edition

Researchers can now broadcast moving holograms

IT IS not merely tractor beams that have a counterpart in the real world (see article). Some recent work by NASA, America's space agency, has produced and broadcast a prototype moving hologram.

SHIVA, the Spaceflight Holography Investigation in a Virtual Apparatus, was conceived in 1999 as an aid to conducting research in space. The "microgravity" environment found in orbit around the Earth has many advantages for scientists who want a greater understanding of physics, chemistry and biology. Unfortunately, excellent living conditions, safety and a regular home life are not among them. The answer is unmanned missions. But experiments on these still need to be controlled and observed, which is hard when the researchers cannot see what is going on.

SHIVA is designed to overcome this by broadcasting moving 3D images—in essence, 3D TV. And James Trolinger, of MetroLaser, a firm based in Irvine, California, has recently demonstrated its viability by using it to conduct, by remote control, a previously unperformed experiment.

Holograms are interference patterns generated by the interaction of a blank reference laser beam with a second beam that has been reflected from an object of interest. If a beam similar to the original reference beam is shone through a hologram, the result is a three-dimensional image of the object scanned.

In principle, making a moving hologram is easy. Just as a moving picture is actually a series of stills shown in quick succession, so a moving hologram would be a series of still holograms. The problem is that individual still holograms contain so much information that they are usually captured on film (indeed, so much information is needed that the film in question has a grain size a tenth to a hundredth that of standard photographic film). The electronic cameras used in television cannot provide anything like this level of resolution, so 3D TV has not been thought a viable proposition.

However, according to Dr Trolinger, electronic holography for scientific purposes need not suffer from that limitation. Instead of trying to grab each frame in a single exposure, the scientist (unlike the entertainer) can wait as the data build up over time. That is the wrinkle which allows SHIVA to work.

The test that Dr Trolinger and his colleagues conducted used SHIVA to look for a phenomenon in fluid dynamics called "history drag". The details do not matter, except to say that this is precisely the sort of experiment that might be carried out in space, in order to eliminate the distorting effects of gravity. Despite being predicted as long ago as 1887, history drag had not before been observed. But Dr Trolinger observed it—and did so remotely with a ground-based version of SHIVA. The holodeck it isn't. But Dr Trolinger has made his point. It should be possible to observe and control such experiments in space. And if digital video cameras improve enough, 3D TV might yet become a reality.

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About sponsorship

Robert Frank

Essential

Nov 11th 2004
From The Economist print edition

Pace MacGill Gallery NY

His freedom and informality changed photography forever

EIGHTY years old this week, Robert Frank is a hugely influential figure in post-war photography. His melancholy, if sophisticated, vision of life, captured in the grainy, informal images in his masterwork, “The Americans”, pioneered a radical new style that has been copied by two generations of black-and-white photographers. A new exhibition at London's Tate Modern, the first in Britain on this scale, shows over 270 works that span Mr Frank's career, including his underground films and videos.

What Mr Frank said about America was not entirely new. Walker Evans's Depression-era photographs had shown the country's isolated underclass before. Yet Mr Frank set aside the conventional rules of photography. In 1955, armed with a Guggenheim Foundation grant and his 35mm Leica, he travelled across America to create his own “visual study of a civilisation”. His image of a desolate row of petrol pumps in New Mexico; a cowboy lounging by a rubbish bin in New York; a morose, stooping lift attendant; a hunched figure by an arrow-shaped neon sign in Los Angeles: all look like amateur snapshots when set against the formal beauty and tonal range of photographs by Edward Weston, say, or Ansel Adams. Yet contrasty black and white, the blurred forms and the figures half-turned away from the camera gave Mr Frank's work an unprecedented feeling of freedom and informality.

Sifting through 28,000 images on contact sheets, Mr Frank selected only 83 for “The Americans”, first published in Paris in 1958, with each photograph printed opposite a blank page. “I wanted,” says Mr Frank, “to show what a tough, lonely place America can be, and the way blacks were treated.” Jack Kerouac, in his introduction to the American edition, placed Mr Frank among “the tragic poets of the world”, while critics judged the book anti-American. By the 1970s, however, Mr Frank's scratchy yet haunting style had become a norm in American photography.

Born in Zurich to German-Jewish parents, Mr Frank took up the study of photography at 17—never wanting, he says, to do anything else. So by the time he left for America in 1948, he had already had five years of experience behind him. After a brief, rather unlikely, stint as a fashion photographer working under Alexey Brodovitch, an art director at *Harper's Bazaar*, he hit the road. He travelled to Peru, Paris and then on to London—where a damp, post-war atmosphere is captured in photographs of a top-hatted stockbroker walking down a dark City of London lane and of a little girl skipping past a hearse.

A highlight of the Tate show is a gallery hung with the snapshots that Mr Frank took in 1958 from the window of a Manhattan bus. They include a couple jiving on the pavement, a harassed businessman crossing the street, a bulging briefcase tucked under his arm, and a black mother and her two children waiting for the lights to change. Mr Frank relied upon intuition to seize the moment. His second wife, June Leaf, once said that he is “like a man with chopsticks who picks the most essential thing out of the

chaos”.

After the huge success of “The Americans”, in the 1960s Mr Frank turned his back on photography, focusing his energies instead on making movies. Several of his films were about his two children, both of whom died painfully young. Indeed, it was the sudden death of his daughter, Andrea, in 1974 that prompted his return to photography. Mr Frank's later work is often made up of different prints that have been cut and then taped together. The strongest paint the bleak surroundings of his home in Mabou, Nova Scotia, as a constant shift in the relationship between landscape and sea.

With an extensive use of contact sheets, the exhibition attempts to place the photographer's work in the context of his life and travels. The images made so famous in “The Americans”, for example, are mixed in with the rest of the exhibition, or they are replaced by adjacent photographs from the same contact sheet. Given that this is Mr Frank's first big exhibition in Britain, such a display may lessen the impact for visitors who are not already familiar with his work.

“Robert Frank: Storylines” is at the Tate Modern until next January 23rd, and at the Museu d'Art Contemporani in Barcelona from February to May 2005. It then moves to Switzerland and Italy.

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Ghostwriting

Tiger burning bright

Nov 11th 2004
From The Economist print edition

THE job has a faintly disreputable whiff about it, at least in the West, where artistic endeavour is seen as an individualistic pursuit: the culture is ill-disposed to shadows being paid to write great chunks of someone else's work. Jennie Erdal's “outing” after 20 years spent ghostwriting the letters, memos, articles and books of a flamboyant London publisher might seem at first disloyal, a further step into disrepute. Yet the ghost turns out to write with such substance that any churlish thoughts are swiftly cast aside.

The book is not, in fact, chiefly about ghostwriting, but rather an extraordinary character whose presence almost wholly overwhelms the subtext of self-deception and of the blurring of truth and reality. At first, Ms Erdal looks to maintain the man's anonymity, but by the end the clues are numerous, and it comes as no surprise to find his name lodged in the penultimate footnote.

Ghosting: A Memoir
By Jennie Erdal

Canongate; 270 pages; £14.99

Buy it at
Amazon.co.uk

Ms Erdal calls him “Tiger”. An obsessive personality burns throughout, from the ghosted love letter to his wife on the first page, where he, or rather she, quotes Larkin and the Delphic oracle, to the end, where Ms Erdal finds him sobbing in his hotel room at the Frankfurt book fair. She assumes he has finally broken under the financial pressure on his business empire. But no, it is the death of his beloved Eclair, a dog. The crying, though, soon stops: “The place where he had wept was at such depths of concealment that he could not remain there for long.”

Tiger's financial problems are the source of one of the book's most poignant sections. A shadowy Greek intermediary promises salvation, possibly from Saudi Arabia. Tiger becomes obsessed with this answer to his problems in a way that many a failed entrepreneur will recognise, and some successful ones too. He dedicates a mobile phone exclusively to the Greek and glowers at it fixedly, willing it to ring. “There was a piercing hopelessness to all this,” writes Ms Erdal, “like the lost dream of a Chekhov play.”

The Chekhovian gloom soon lifts. A rich vein of humour runs through the book. At one stage, Tiger becomes a novelist and decides on a book about two women who are able to experience sympathetic orgasms on opposite sides of the Atlantic. Ms Erdal, stretching her imagination to put flesh on the bones of this male fantasy, tries to put Tiger off the idea. At every opportunity, she introduces descriptions of bodily fluids, to which she knows he has an aversion. Thus she tries: “He slides over her moist skin through the sweet damp valley between her breasts”, before “he caresses her and spins a silver spider's web from the threads of her wetness”. Read this delightful book to see if her ploy works. Then watch out for the first novel to appear in Ms Erdal's own name.

Ghosting: A Memoir.
By Jennie Erdal.
Canongate; 270 pages; £14.99

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About sponsorship

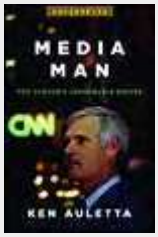
Ted Turner

Tenacious

Nov 11th 2004
From The Economist print edition

IT IS hard to imagine a powerful man more out of step with the political direction of his country than Ted Turner, founder of CNN. Mr Turner is an agnostic and an environmentalist. He pledged over $1 billion of his fortune to the United Nations. His theory of diplomacy is that “just about everybody will be friendly toward us if we are friendly with them.” After the September 11th terrorist attacks, his former company, AOL Time Warner, disowned him when he said that the hijackers' suicides were brave.

Media Man: Ted Turner's Improbable Empire
By Ken Auletta



Norton; 160 pages; $22.95

Buy it at
Amazon.com

Ken Auletta's story of Mr Turner's life is edged with defeat. The early triumphs came fast: he built the first 24-hour international news network, amassing billions of dollars along the way and becoming the biggest individual landowner in America. The innovation of CNN challenged the dominant broadcast networks and set in motion the steady rise of cable television. Outside broadcasting, Mr Turner was a hugely talented sailor. He won the America's Cup in 1977, on *Courageous*, and the stormy Fastnet race in 1979.

Yet now Rupert Murdoch's Fox News, prejudiced in favour of the political right, is trouncing a duller, and certainly less biased, CNN for viewers. It is a triumph for Mr Murdoch's world view. Mr Turner once said of his rival that there wasn't “a spark of human decency in him, except he likes his family”.

Mr Turner has lost financially as well as politically. He owned one-tenth of Time Warner, a media giant which along the way had absorbed Turner Broadcasting and CNN. At the time, Mr Turner supported Time Warner's merger with AOL. Four months after the deal was consummated, he was ousted from his job. The firm's share price plunged, and Mr Turner lost $5 billion in paper wealth.

This short biography does an excellent job of describing how Mr Turner's upbringing influenced him, and of painting a portrait of his marriage to Jane Fonda, which ended after the ever radical actress became a born-again Christian. His father was a domineering, depressive man who doted on his son, but punished him severely for his rebellions. “I am appalled, even horrified”, wrote Ed Turner to his son at university, “that you have adopted Classics as a Major. As a matter of fact, I almost puked on the way home today.” The father shot himself dead after a row with his son, then 24, about the family business. Mr Turner continued to try proving his worth.

Not included in the book is Mr Turner's most recent campaign: against, of all things, the harmful effects of big media. In an article this summer in the *Washington Monthly*, he wrote that it would be impossible to start a business like CNN today, because the American media industry is so concentrated. Time Warner, Disney, News Corporation and Viacom should, he says, all be broken up.

Media Man: Ted Turner's Improbable Empire.
By Ken Auletta.
Norton; 160 pages; $22.95

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About sponsorship

British politics

Browned off

Nov 11th 2004
From The Economist print edition

LEARNING that Tom Bower is writing your biography is the kind of news that would put most of us off our cornflakes. Mr Bower is not as relentlessly unpleasant as Kitty Kelley, and is a more scrupulous journalist. However, Mr Bower chooses his subjects not because he admires them, but because he thinks they have something to hide. He has written revelatory books about, among others, Robert Maxwell, Mohammed Fayed and Tiny Rowland. Given that Gordon Brown is neither a businessman nor a colourful rogue, he is an unusual target for Mr Bower.

Gordon Brown
By Tom Bower

Harper Collins; 492 pages; £20

Buy it at
Amazon.co.uk

Yet Britain's longest-serving chancellor of the exchequer, and the man most people assume will succeed Tony Blair, does have something in common with the author's earlier victims. By nature, Mr Brown is secretive. “Brooding”, “enigmatic” and “saturnine” are the kinds of words journalists reach for when attempting to describe him. Mr Brown is not a politician who is eager to please.

The most fascinating story in British politics, and also the longest-running, is Mr Brown's strained yet umbilical relationship with Mr Blair. It is a staple for political reporters and commentators, and has been the basis for more than one book. Nearly every twist and turn in the Labour government's fortunes have to be seen in the context of the struggle for dominance within this complex partnership. It is a war fuelled by Mr Brown's sense of injustice, but, true to the nature of the man, fought largely behind closed doors and more often by proxies than by the principals themselves.

A large part of Mr Bower's purpose is to provide an insight into the psychology and the circumstances that have made Gordon Brown, in his view, both formidable and flawed. Mr Brown declined to meet the author and (unsuccessfully, it seems) instructed those close to him not to co-operate. As a consequence, the book both gains and loses something.

What it loses most is Mr Brown's own voice, other than in platform speeches and the occasional television or radio interview (the most revealing of which was Sue Lawley's on “Desert Island Discs”). Given Mr Brown's obsession with privacy, it would be a real scoop if anyone could persuade him to unbutton and talk about his personal life and feelings. The small group of people who are close to the chancellor testify to his jolliness when surrounded by trusties. The rest of us will have to take their word for it.

What the book gains is Mr Bower's bleak objectivity. Unlike most political commentators, who need to remain more or less on speaking terms with Mr Brown, Mr Bower does not have to worry about being frozen out by the chancellor if he causes offence.

The picture that emerges is not flattering. Mr Bower concedes that Mr Brown's recent marriage and the birth of a son may have softened the iron chancellor. But he nonetheless depicts him as a selfish, driven misogynist, only happy when working late at night in his Treasury lair or out on a boys' outing with his loyal and typically rather laddish acolytes. The author acknowledges the chancellor's seriousness of purpose and admires his passionate commitment to relieving poverty both at home and abroad. However, despite Mr Brown's largely successful management of the economy, Mr Bower is critical of the microeconomic tinkering. He questions whether, for all of the chancellor's rhetoric about enterprise, Mr Brown really understands business and its needs.

The author believes Mr Brown is the guilty party when it comes to the fractious dealings with the prime minister. Notably, he gives short shrift to the idea that Mr Blair has ever agreed to stand aside in Mr Brown's favour, either a decade ago or more recently. It is a myth, he suggests, used by Mr Brown to

feed his resentment.

Mr Bower, however, still expects Mr Brown to become prime minister one day. It would hardly be good for sales if he thought otherwise. It is possible, he writes, that the office might evoke “hitherto unseen qualities to silence the critics and the cynics”. But, in conclusion, “the substance of a future Brown government remains an enigma, reflecting the unresolved conflicts bedevilling the man himself”. Fair enough, but readers of this book are unlikely to be reassured.

Gordon Brown.
By Tom Bower.
Harper Collins; 492 pages; £20

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About sponsorship

Teenagers alone

Feral and furious

Nov 11th 2004
From The Economist print edition

“IT WOULD be better for both children and adults if more American parents were with their kids more of the time,” insists Mary Eberstadt, at the end of a gloomy account of all that has gone wrong with youngsters' lives. She wants a new public consensus to reflect that.

Can views change? Public concern about the absence of fathers from their children's lives has already begun to rise in the past decade. Indeed, the author's catalogue of childhood unhappiness sometimes conflates the effects of divorce with her main and more controversial target, namely, the decline in the amount of time that children spend with either parent. She blames the rise of day care and of empty homes for rising aggression, obesity, unhappiness and teenage sex. The average American teenager now spends about three-and-a-half hours alone each day: more time alone than with family and friends. In that loneliness, and in children's resentment of it, lie the roots of most of the ills that beset America's youngsters.

Home-Alone America: The Hidden Toll of Day Care, Wonder Drugs, and Other Parent Substitutes
By Mary Eberstadt

Sentinel; 218 pages; $25.95

Buy it at Amazon.com

The loneliness, Mrs Eberstadt argues, starts in day care. Deposited, by working mothers, too soon and too long in the care of strangers, small children suffer more infections and develop more aggressive behaviour than they once did. At school, children whose parents are out of the home for long periods behave worse and achieve less. Violence in primary schools has grown. So has childhood obesity: the proportion of overweight youngsters tripled between the 1960s and 1990s. Why? Because, says Mrs Eberstadt, there is no longer an adult at home to tell a sedentary child to stop munching in front of the television and go out to play. She cites research showing a significant link between maternal work and overweight children. Television makes the dual-career and single-parent family possible.

Children hate being parentless. But the adult response to what she calls the “furious child problem” has been pharmaceutical: prescription-drug use is now rising faster among children than among the elderly. Schools have difficulty managing “feral” children, their behaviour undisciplined by a parental presence at home. Teenagers left alone at home for too long get up to greater mischief. And she reports a rising epidemic of sexually transmitted diseases among teenagers. Parents are “the ultimate prophylactic”.

The figures do not always support her alarm. Teenage crime and suicide have been falling recently, and pregnancy is not rising. There is, she feels, strong “cultural pressure” to suppress what is up with kids today. But her passionate attack on the damage caused by the absence of parents suggests that we may be approaching some sort of turning point in social attitudes, where assumptions about family life and maternal employment start to change. It has happened before—it could happen again.

Home-Alone America: The Hidden Toll of Day Care, Wonder Drugs, and Other Parent Substitutes.
By Mary Eberstadt.
Sentinel; 218 pages; $25.95

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New fiction

Party time

Nov 11th 2004
From The Economist print edition

STUDENTS at America's elite universities, Tom Wolfe seems to want you to know, devote much time to sex: thinking about it, talking about it and even doing it. They shag on the floor in front of the television, barely braking for an incoming roommate. They have fivesomes. What is more, young ladies are just as bad as the lads, if not worse: chasing down campus athletes for sport, and to mark their status. In case you need convincing, a sample.

> "Sex! Sex! It was in the air along with the nitrogen and the oxygen! The whole campus was humid with it! tumid with it! lubricated with it! gorged with it! tingling with it! in a state of around-the-clock arousal with it! Rutrutrutrutrutrutrutrut—"

In "The Bonfire of the Vanities" and "A Man in Full", Mr Wolfe has chronicled big themes in American life before; this time, it is the turn of campus culture. In the lust-drenched fields of Dupont University, a fictional place just outside Philadelphia, deified but less than gifted athletes share the same air, but little more, with the confident crowd that makes up America's best and brightest. It is the usual mix of well born fraternity boys, prep-school girls, budding intellectuals and a motley crew of "diversoids".

I Am Charlotte Simmons
By Tom Wolfe

Farrar, Straus and Giroux; 676 pages; $28.95.
Jonathan Cape; £20

Buy it at
Amazon.com
Amazon.co.uk

Into this mix steps Charlotte Simmons, a hardworking prodigy from backwoods North Carolina, the reddest part of a very red state. Momma worships at the Church of Christ's Evangel. Daddy's shoe-factory job has been offshored to Mexico, and he now tends house part-time for the "summer people" in the Blue Ridge mountains. A spartan high-school graduation party for the valedictorian Charlotte is but a prelude to the much raunchier parties yet to come. Charlotte's Victorian morals and her love of learning for its own sake will be severely tested. "Know'm saying?", as one of Mr Wolfe's rap-influenced characters might put it.

Mr Wolfe's aim, with characters that admittedly are often little more than cardboard cut-outs, is not really to expose the sex and the savage idiocy of the American academy, but rather the countless markers of status. The novelist charts the tiniest vocal inflection, the subtle role that khaki trousers play in marking your place in society, or how a character wears his fleece jacket. Mr Wolfe's gifts for sartorial detail, verbal tics and all the tiny gestures that define place in the social pecking order are on hyperkinetic, at times tiresome, display.

Dupont University's secrets are thereby laid bare. There is a fetishism for sport and a fascination, even among the scrawny, for weightlifting. There is the yearning of a brainy reporter on a student newspaper to be not a mere Rhodes Scholar, but rather a "Bad-Ass Rhodie", a category which assures not only your intellectual independence, but also a place among the emerging merito-aristocracy. A scandal involving a Republican governor of California caught one night with his trousers down and a co-ed between his knees serves to bring about a reversal of fortune. A rather unlikely love story emerges. But if a few stock characters and a contrived peccadillo are what it takes in order to exaggerate and deflate the pretensions of America's future ruling class in such hilarious style, so be it.

I Am Charlotte Simmons.
By Tom Wolfe.
Farrar, Straus and Giroux; 676 pages; $28.95.
Jonathan Cape; £20

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About sponsorship

Obituary

Yasser Arafat

Nov 11th 2004
From The Economist print edition

Yasser Arafat, leader of the Palestinians, died on November 11th, aged 75

AFP

IN HIS dying, as in his life, Yasser Arafat seemed both dogged and indecisive. To the Palestinians, the people he led for so long, Mr Arafat's flaws of character and leadership had been plain for years, yet were irrelevant. What mattered was that he personified their fight for freedom, kept alive their hopes and defied their enemies.

His career as “Mr Palestine” began in 1953 when, as a student in Egypt, he wrote “Don't Forget Palestine” in blood and presented the petition to General Neguib, Egypt's military leader. Five years later in Kuwait, disenchanted with the Arab world's inability to do anything about Israel's 1948 conquests, he and close comrades formed the Fatah movement, a word that itself meant “conquest”. From that moment he was, in effect, the leader of Palestinian resistance, though it was not until 1969, after the Arabs' 1967 war with Israel, that he formally became chairman of the Palestine Liberation Organisation (PLO).

As leader, he inspired his followers but also failed them. The group at the top of the PLO developed into a corrupt coterie. The Palestinian Authority, which was formed in the early 1990s under Mr Arafat's leadership as the government of the West Bank and Gaza, was not much better. Mr Arafat, vacillating and poor at administration—yet unwilling to delegate—stayed too faithful to some of his old friends. Many of these grew fat on other people's money; others took to brutal tactics.

Under Mr Arafat's early rule, the PLO's terrorist strategy—hijacking aircraft to bring the Palestinian cause to world attention, for instance—was dubious, at best. Based in Jordan, the one Arab country that has been generous to Palestinian refugees, the PLO sought to act independently of the Jordanian authorities and, in 1971, it was bloodily thrown out. It resettled in Lebanon, where the pattern was repeated, though far more painfully. Running a state within the state, the PLO contributed to the Lebanese disaster that culminated in Israel's 1982 invasion. After American intervention on his behalf, Mr Arafat and his troupe were allowed to trail out of Lebanon to seek refuge in Tunisia, where they sat disconsolately. It was a dismal time in Mr Arafat's, and the Palestinians', fortunes—the two, as ever, were conjoined.

But in 1988 Mr Arafat made the move that transformed him from resistance leader to statesman and potential president: he explicitly recognised Israel, renounced terrorism—for the first of many times—and publicly accepted the principle of two states, Israel and Palestine, side by side. The transformation was slow, and not universally believed: Mr Arafat appeared at the United Nations talking of peace, but with a gun in his holster. From then on, however, the question was not whether Israel and Palestine would negotiate their two states, but when and how.

In two minds

The question is still hanging, despite the Oslo accords that in 1993 appeared to point the way—and gave Mr Arafat a Nobel peace prize. It was up to him and to his Israeli interlocutors to hack their path through the Oslo thickets, but both sides failed miserably. The Israelis procrastinated, missing deadlines for withdrawal and ceaselessly building ever-expanding settlements on the land that was destined to be Palestine. Mr Arafat's great weakness was his inability to make up his mind about the use of violence. He knew that, to gain his country's independence, he had to be against it, and indeed stop it. But he also

believed that violence might be the only way to get Israel to budge.

His ambivalence was made worse by Palestinian politics. As life on the ground deteriorated, the Islamist militant group, Hamas, grew ever more popular. Mr Arafat had to decide whether to act against Hamas, or to compete with it by letting his own men attack Israeli targets. Again, he could never, it seemed, make up his mind.

The defining moment of his life as a negotiator came at Camp David in 2000, when President Bill Clinton got him and Ehud Barak together to try to resolve the matter. Mr Barak offered, or sort-of offered, a larger share of the West Bank to Mr Arafat than any Israeli leader seems likely to offer again, at least in the foreseeable future. It was a tragedy, of his own making, that Mr Arafat did not grab this, using it as a decent starting-point for an acceptable bargain. True, there would have been fury in Palestine, where his people were convinced that they had already made enough territorial concessions by accepting that Israel should have 78% of the original Palestinian mandate. But if Mr Arafat had led the way, his people would surely have followed.

However, Mr Arafat let the offer slip through his fingers, failing to respond with a reasonable counter-proposal. As usual, he dithered. Mr Clinton despaired of his temporising, and brought the summit to an end. The results are all too well known. A Palestinian uprising broke out, Mr Barak was succeeded by Ariel Sharon, Mr Arafat was incarcerated in his compound in Ramallah, and all hope of a decent solution has vanished, at least for the time being.

So why, if Mr Arafat was so bad at running things, taking his people eventually to catastrophe, was he still so honoured as a leader? The answer is that he, and he alone, stood for the courage and perseverance that the Palestinians show in their long, unfinished war with Israel.

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Overview

Nov 11th 2004
From The Economist print edition

America's Federal Reserve raised interest rates for a fourth time this year, by a quarter point to 2%. This followed better-than-expected jobs figures for October: non-farm payrolls rose by 337,000. However the jobless rate rose to 5.5% from 5.4% in September as previously discouraged workers rejoined the labour force.

America's trade figures in September were also better than expected. The deficit on trade in goods and services fell to $51.6 billion from $53.5 billion in August, thanks to stronger exports. The 12-month trade deficit in goods alone rose to a record $621 billion. Despite better news on trade, **the dollar's** trade-weighted value fell again, to 4.2% below its level a month ago. The euro touched an all-time high of $1.30 against the dollar.

Germany's real GDP grew by only 0.1% in the third quarter over the previous three months. It was 1.3% higher than in the same quarter of 2003. German industrial production grew by 2.5% in the year to September.

French industrial production unexpectedly jumped by 3.2% in September, leaving output 2.9% up on a year earlier. The strong rise was mainly due to a rebound in car production after a sharp fall in August when a big car plant was temporarily closed.

Retail sales in the **euro area** were flat in the year to September.

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Output, demand and jobs

Nov 11th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.1	Q2	+ 2.5	+ 3.6	+ 3.2	+ 4.6	Q2	+ 7.9	Q2	5.3	Oct	5.9
Austria	+ 1.8	Q2	+ 3.5	+ 1.6	+ 2.1	+ 9.5	Aug	+ 3.2	Aug	4.5	Oct	4.6
Belgium	+ 3.0	Q3	+ 3.2	+ 2.4	+ 2.1	+ 4.0	Aug	+ 0.9	Aug	13.2	Oct†	12.9
Britain	+ 3.0	Q3	+ 1.5	+ 3.2	+ 2.5	– 0.9	Sep	+ 6.9	Sep	4.7	Aug††	5.0
Canada	+ 3.0	Q2	+ 4.3	+ 3.0	+ 3.3	+ 6.4	Aug	+ 2.4	Jul	7.1	Oct	7.6
Denmark	+ 2.6	Q2	+ 1.0	+ 2.3	+ 2.3	– 2.6	Sep	+ 4.2	Sep	6.3	Sep	6.3
France	+ 2.8	Q2	+ 2.8	+ 2.4	+ 2.2	+ 2.9	Sep	+ 1.0	Aug	9.9	Sep	9.9
Germany	+ 1.3	Q3	+ 0.4	+ 1.5	+ 1.6	+ 2.5	Sep	– 1.4	Sep	10.7	Oct§	10.5
Italy	+ 1.2	Q2	+ 1.1	+ 1.1	+ 1.6	– 3.5	Aug	– 4.0	Aug	8.1	Apr	8.7
Japan	+ 4.2	Q2	+ 1.3	+ 4.3	+ 2.1	+ 3.8	Sep	– 1.6	Aug	4.6	Sep	5.1
Netherlands	+ 1.4	Q3	+ 0.8	+ 1.2	+ 1.6	– 0.6	Sep	– 0.7	Jun‡	6.1	Sep**	5.4
Spain	+ 2.6	Q3	+ 2.4	+ 2.6	+ 2.5	+ 3.9	Sep	+ 0.2	Sep	10.6	Sep	11.3
Sweden	+ 3.6	Q2	+ 4.0	+ 3.4	+ 2.9	+ 5.3	Sep	+ 5.2	Sep	5.8	Sep†	4.8
Switzerland	+ 2.0	Q2	+ 1.6	+ 1.8	+ 2.0	+ 4.3	Q2	+ 3.1	Aug	3.7	Oct†	3.8
United States	+ 3.9	Q3	+ 3.7	+ 4.4	+ 3.4	+ 4.6	Sep	+ 6.3	Sep	5.5	Oct	6.0
Euro area	+ 2.0	Q2	+ 2.0	+ 1.8	+ 1.9	+ 1.5	Aug	nil	Sep	8.9	Sep	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.7	Q2	+ 2.9	na	na	+ 5.1	Sep	+ 3.8	Aug	7.2	Sep†	8.0
Greece	+ 3.9	Q2	– 0.6	na	na	– 0.5	Aug	+ 6.6	Jul	na		na
Iceland	+ 6.2	Q2	na	na	na	na		na		2.6	Sep†	2.7
Ireland	+ 4.1	Q2	na	na	na	–12.6	Aug	+ 4.5	Aug	4.4	Oct	4.6
Luxembourg	+ 2.1	2003	na	na	na	– 1.2	Dec	– 8.2	Sep	4.2	Sep	3.8
New Zealand	+ 6.0	Q2	+ 4.6	na	na	+ 5.5	Q2	+ 6.8	Q2	4.0	Q2	4.7
Norway	+ 4.1	Q2	+ 5.0	na	na	– 3.3	Sep	+ 2.0	Sep	3.7	Oct	3.8
Portugal	+ 1.5	Q2	+ 4.7	na	na	– 3.6	Sep	+ 3.6	Sep	6.3	Q2†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Jun-Aug; claimant count rate 2.7% in Sep. §EU harmonised rate 9.9% in Oct. **Jul-Sep.

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Prices and wages

Nov 11th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.3	Q3	+ 2.6	+ 2.5	+ 2.7	+ 6.1	Q3	– 0.1	+ 2.9	Q2	+ 5.5
Austria	+ 2.1	Sep	+ 1.4	+ 1.7	+ 1.6	+ 6.0	Oct	+ 2.0	+ 2.0	Sep	+ 2.3
Belgium	+ 2.9	Oct	+ 1.6	+ 2.0	+ 1.8	+ 6.0	Sep	– 1.4	+ 2.2	Jul	+ 1.9
Britain	+ 1.1	Sep*	+ 1.4	+ 1.4	+ 1.7	+ 3.5	Oct	+ 1.5	+ 3.9	Aug†	+ 3.4
Canada	+ 1.8	Sep	+ 2.2	+ 2.0	+ 2.2	+ 4.6	Sep	– 2.7	+ 2.2	Aug	+ 3.5
Denmark	+ 1.7	Oct	+ 1.4	+ 1.2	+ 1.8	+ 3.4	Sep	– 0.5	+ 3.1	Q2	+ 3.8
France	+ 2.1	Sep	+ 2.1	+ 2.3	+ 1.7	+ 3.1	Sep	+ 0.1	+ 2.8	Q2	+ 2.7
Germany	+ 2.0	Oct	+ 1.2	+ 1.8	+ 1.4	+ 4.2	Oct	+ 0.6	+ 1.5	Aug	+ 2.0
Italy	+ 2.0	Oct	+ 2.6	+ 2.3	+ 2.1	+ 3.9	Sep	+ 1.0	+ 2.5	Sep	+ 2.7
Japan	nil	Sep	– 0.2	– 0.1	+ 0.1	+ 1.9	Oct	– 0.5	+ 0.7	Sep	+ 1.5
Netherlands	+ 1.4	Oct	+ 2.0	+ 1.4	+ 1.3	+ 6.0	Sep	– 0.3	+ 1.1	Sep	+ 2.6
Spain	+ 3.5	Oct	+ 2.7	+ 2.9	+ 2.8	+ 4.6	Sep	+ 0.8	+ 3.1	Q2	+ 4.2
Sweden	+ 0.6	Sep	+ 1.7	+ 0.7	+ 1.6	+ 2.1	Sep	– 1.5	+ 2.2	Aug	+ 3.3
Switzerland	+ 1.3	Oct	+ 0.5	+ 0.7	+ 1.1	+ 1.5	Sep	– 0.4	+ 1.4	2003	+ 1.8
United States	+ 2.5	Sep	+ 2.3	+ 2.6	+ 2.3	+ 3.3	Sep	+ 3.5	+ 2.4	Sep	+ 2.4
Euro area	+ 2.5	Oct	+ 2.0	+ 2.1	+ 1.8	+ 3.4	Sep	+ 1.1	+ 2.1	Q2	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.4	Sep	+ 0.7	na	na	+ 2.5	Sep	– 0.7	+ 3.5	Q2	+ 4.4
Greece	+ 3.2	Oct	+ 3.2	na	na	+ 2.1	Aug	+ 2.2	na		na
Iceland	+ 3.8	Nov	+ 2.5	na	na	+ 5.6	Oct	+ 3.7	+ 5.3	Sep	+ 5.6
Ireland	+ 2.5	Sep	+ 2.9	na	na	– 0.8	Sep	– 7.8	+ 3.8	Q2	+ 8.0
Luxembourg	+ 2.5	Oct	+ 1.7	na	na	+11.0	Aug	+ 0.5	– 0.4	Dec	+ 0.7
New Zealand	+ 2.5	Q3	+ 1.5	na	na	+ 1.5	Q2	– 1.9	+ 2.3	Q2	+ 2.3
Norway	+ 1.4	Oct	+ 1.6	na	na	+24.1	Oct	+ 2.1	+ 4.5	Q2	+ 5.4
Portugal	+ 2.1	Sep	+ 3.1	na	na	+ 4.5	Sep	– 0.2	+ 1.4	Sep	– 1.8

*New series. RPI inflation rate 3.1% in Sep. †Jun-Aug.

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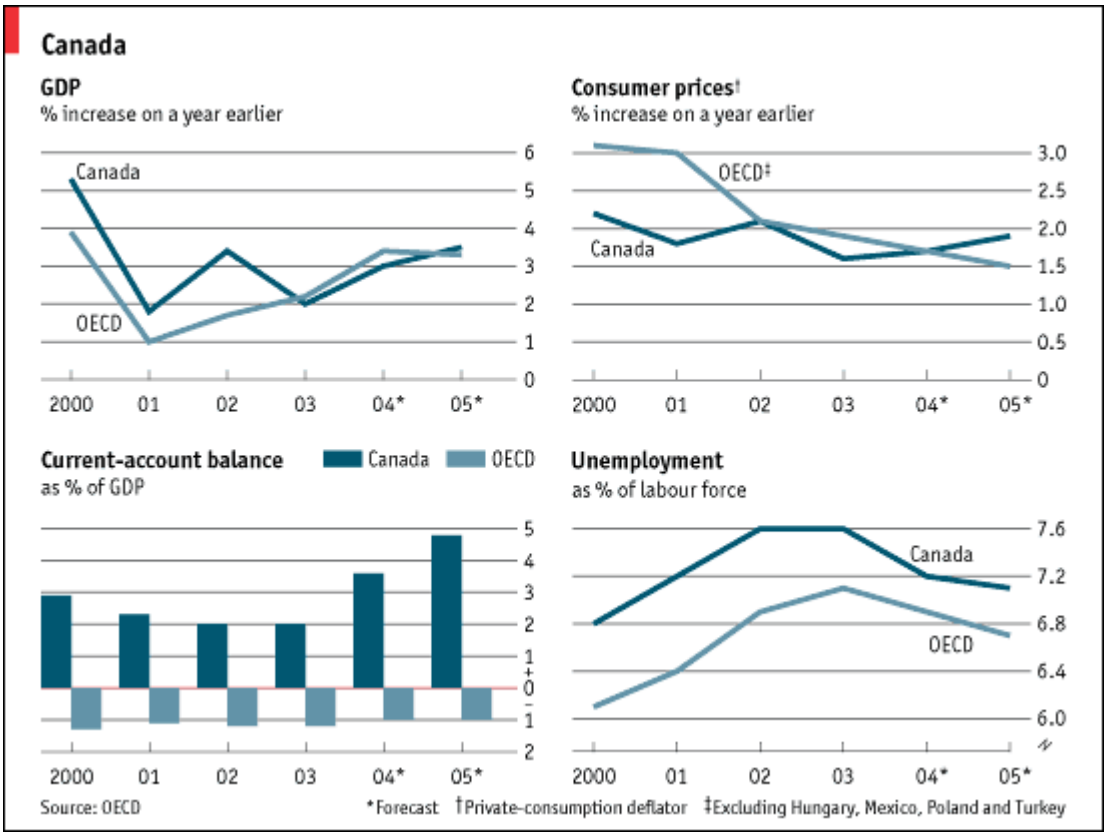
Canada

Nov 11th 2004
From The Economist print edition

Canada's economy has performed well since its mild slowdown in 2001. In a new report the OECD forecasts growth of 3% this year and 3.5% in 2005. Canada's current-account surplus is expected to grow to 4.8% of GDP next year. Even so, the Canadian dollar's strong rise over the past two years has put pressure on companies to boost productivity. That would also be helpful in raising GDP per head closer to American levels. The OECD also reckons that the country could do much to deepen participation in the labour force and reduce its higher-than-average unemployment rate. First, it should be less generous with jobless benefits. Second, it should reduce the high marginal income-tax rates faced by families on modest incomes. The OECD encourages Canada to keep a watchful eye on public finances, in part by encouraging more efficiency in the health-care system.



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Money and interest rates

Nov 11th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Nov 10th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.2	+ 9.7	Sep	5.44	5.31	5.15	5.49	5.93	6.28
Britain	+ 5.8	+ 9.3	Sep	4.84	3.91	4.57	4.74	5.04	5.36
Canada	+ 9.6	+ 9.1	Sep	2.66	2.73	3.33	4.56	4.98	5.93
Denmark	+ 9.8	+10.7	Sep	2.25	2.30	2.57	3.90	4.58	5.28
Japan	+ 4.3	+ 2.1	Oct	0.03	0.02	0.12	1.49	1.37	1.60
Sweden	+ 1.6	+ 3.1	Sep	2.03	2.73	2.61	4.15	4.98	2.66
Switzerland	– 2.0	+ 0.6	Sep	0.75	0.27	1.09	2.47	2.80	2.40
United States	+ 5.0	+ 4.8	Sep	2.23	1.30	2.85	4.25	4.41	5.69
Euro area†	+ 9.7	+ 6.0	Sep	2.17	2.17	2.44	3.83	4.42	3.68

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.96%, Japan No. 264 1.48%. Central bank rates: US fed funds 2.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 11th 2004
From The Economist print edition

1995=100

	Nov 2nd	Nov 9th*	% change on one month	% change on one year
Dollar index				
All items	86.0	86.6	– 1.3	– 0.3
Food	78.5	79.3	+ 0.5	– 9.1
Industrials				
All	96.2	96.6	– 3.3	+11.8
Nfa†	81.2	81.4	– 0.6	– 8.0
Metals	108.9	109.5	– 4.9	+29.3
Sterling index				
All items	73.8	73.6	– 5.0	–10.5
Euro index				
All items	89.1	88.2	– 6.0	–11.0
Yen index				
All items	97.2	97.5	– 5.0	– 3.0
Gold				
$ per oz	421.43	434.55	+ 5.0	+11.9
West Texas Intermediate				
$ per barrel	49.59	47.34	– 9.8	+52.1

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 11th 2004
From The Economist print edition

Market indices

	Nov 10th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,846.4	3,854.5	3,274.9	+ 0.2	– 0.2	+16.3	+17.3
Austria (ATX)	2,186.5	2,186.5	1,568.9	+ 1.3	nil	+41.5	+44.9
Belgium (Bel 20)	2,849.8	2,849.8	2,244.2	+ 0.3	–22.6	+27.0	+30.0
Britain (FTSE 100)	4,734.5	4,739.8	4,287.0	+ 0.3	–31.7	+ 5.8	+ 9.1
Canada (Toronto Composite)	8,841.7	8,898.8	8,123.5	nil	–22.4	+ 7.6	+16.0
Denmark (KBX)	250.9	253.0	219.0	+ 1.3	–16.8	+17.5	+20.5
France (SBF 250)	2,591.6	2,594.4	2,386.1	+ 0.5	–41.0	+ 7.5	+10.0
(CAC 40)	3,784.9	3,811.4	3,465.3	+ 0.4	–45.3	+ 6.4	+ 8.9
Germany (DAX)	4,089.1	4,151.8	3,647.0	+ 1.2	–49.3	+ 3.1	+ 5.6
Italy (BCI)	1,390.8	1,390.8	1,239.5	+ 0.6	–36.3	+10.7	+13.3
Japan (Nikkei 225)	10,995.0	12,163.9	10,365.4	+ 1.0	–71.7	+ 3.0	+ 3.2
(Topix)	1,100.7	1,217.9	1,022.6	+ 0.5	–61.8	+ 5.5	+ 5.7
Netherlands (AEX)	338.4	364.8	310.7	+ 0.9	–51.8	+ 0.2	+ 2.6
Spain (Madrid SE)	899.9	904.0	804.4	+ 0.2	–21.5	+11.4	+14.0
Sweden (Affarsvarlden Gen)	215.8	218.1	188.5	+ 1.0	–46.1	+14.6	+17.5
Switzerland (Swiss Market)	5,609.6	5,934.4	5,309.7	+ 1.3	–33.3	+ 2.2	+ 7.2
United States (DJIA)	10,385.5	10,737.7	9,750.0	+ 2.5	–11.4	– 0.7	– 0.7
(S&P 500)	1,162.9	1,166.2	1,063.2	+ 1.7	–23.9	+ 4.6	+ 4.6
(NASDAQ Comp)	2,034.6	2,153.8	1,752.5	+ 1.5	–59.7	+ 1.6	+ 1.6
Europe (FTSE Eurotop 300)*	1,021.9	1,026.2	940.9	+ 0.3	–40.1	+ 6.7	+ 9.2
Euro area (FTSE Ebloc 100)*	873.7	888.3	787.2	+ 0.5	–43.6	+ 5.1	+ 7.6
World (MSCI)†	1,104.7	1,108.5	997.0	+ 1.3	–23.8	+ 6.6	+ 6.6
World bond market (Citigroup)‡	634.7	637.3	575.1	+ 0.2	– 0.4	+ 5.1	+ 5.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Nov 11th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Nov 10th	year ago	Currency units per $ Nov 10th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 17.0	Sep	− 34.2	Q2	− 5.8	− 5.3	87.3	86.4	1.32	1.39	2.43	1.70	1.23	+ 0.5
Austria	− 0.5	Aug	− 1.2	Aug	− 0.3	− 0.4	103.1§	102.6	0.77	0.86	1.43	–	0.72	− 1.3
Belgium	+ 20.6	Aug	+ 13.0	Jun	+ 3.3	+ 3.2	103.3§	102.7	0.77	0.86	1.43	–	0.72	− 0.2
Britain	−101.1	Sep	− 41.7	Q2	− 2.5	− 2.7	101.6	100.1	0.54	0.60	–	0.70	0.51	− 2.9
Canada	+ 50.2	Sep	+ 23.8	Q2	+ 2.8	+ 2.5	95.6	89.2	1.20	1.30	2.21	1.55	1.12	+ 1.2
Denmark	+ 10.1	Aug	+ 6.8	Aug	+ 2.9	+ 2.6	107.2	105.8	5.75	6.39	10.6	7.43	5.38	+ 0.9
France	− 2.8	Sep	− 2.0	Aug	+ 0.3	+ 0.3	106.8§	106.0	0.77	0.86	1.43	–	0.72	− 3.8
Germany	+186.4	Sep	+ 90.2	Sep	+ 3.2	+ 2.9	104.5§	103.5	0.77	0.86	1.43	–	0.72	− 3.7
Italy	+ 3.2	Aug	− 12.2	Aug	− 0.9	− 1.1	76.2§	75.5	0.77	0.86	1.43	–	0.72	− 3.1
Japan	+134.5	Sep	+169.0	Sep	+ 3.5	+ 3.5	134.2	138.3	107	109	197	138	–	− 7.1
Netherlands	+ 34.2	Aug	+ 20.7	Q2	+ 2.9	+ 3.0	102.8§	102.1	0.77	0.86	1.43	–	0.72	− 3.1
Spain	− 66.3	Aug	− 35.8	Jul	− 3.4	− 3.6	77.3§	76.9	0.77	0.86	1.43	–	0.72	+ 0.3
Sweden	+ 23.1	Sep	+ 23.4	Q2	+ 7.0	+ 6.4	82.8	82.3	7.01	7.70	12.9	9.06	6.56	+ 0.2
Switzerland	+ 7.9	Sep	+ 45.0	Q2	+11.3	+10.8	115.0	109.8	1.18	1.35	2.18	1.52	1.10	− 1.6
United States	−621.1	Sep	−571.9	Q2	− 5.5	− 5.4	91.7	98.5	–	–	1.85	1.29	0.93	− 4.7
Euro area	+106.4	Aug	+ 60.3	Aug	+ 0.6	+ 0.6	93.1	89.4	0.77	0.86	1.43	–	0.72	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.6	Aug	+ 8.5	Aug	na	na	82.2§	81.5	0.79	0.86	1.46	–	0.74	+ 1.6
Greece	− 29.6	Aug	− 10.9	Aug	na	na	59.7§	59.3	0.79	0.86	1.46	–	0.74	− 3.2
Iceland	− 0.4	Sep	− 0.6	Q2	na	na	96.1**	95.0	67.9	75.9	125	87.7	63.5	+ 0.2
Ireland	+ 42.5	Aug	− 1.7	Q2	na	na	94.8§	94.2	0.79	0.86	1.46	–	0.74	− 0.5
Luxembourg	− 4.3	Aug	+ 2.1	Q2	na	na	103.3§	102.7	0.79	0.86	1.46	–	0.74	− 1.8
New Zealand	− 2.6	Sep	− 3.9	Q2	na	na	105.6	101.3	1.46	1.60	2.70	1.89	1.36	+ 2.9
Norway	+ 31.4	Sep	+ 31.7	Aug	na	na	99.2	97.5	6.34	7.03	11.7	8.19	5.93	+ 10.4
Portugal	− 16.6	Jul	− 11.2	Aug	na	na	93.6**	93.6	0.79	0.86	1.46	–	0.74	− 3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, September average. ‡OECD forecast. **IMF, July average.

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The Economist commodity price index

Nov 11th 2004
From The Economist print edition

Our dollar-based commodity index has fallen by 14% since April, but is still 38% above its low in 2001. Measured in euros, our index has fallen by only 3% over the same period.

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Overview

Nov 11th 2004
From The Economist print edition

Industrial production in **China** increased by 15.7% in the year to October. In **Malaysia**, industrial output rose by 9.8% in the 12 months to September, the slowest growth for a year. In the **Philippines**, consumer prices rose by 7.1% in the year to October.

Industrial production in **Brazil** was flat in September, leaving it 7.6% higher than a year before. Over the same 12 months, industrial output in **Peru** rose by 4.0%. In **Mexico**, consumer prices increased by 5.4% in the year to October.

In **Turkey**, growth in industrial output slowed to 5.4% in the year to September. In **South Africa**, production rose by 6.1% over the same period.

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The Economist poll of forecasters

Nov 11th 2004
From The Economist print edition

Every three months, *The Economist* polls a group of forecasters and averages their predictions for growth and current-account balances in 25 emerging economies. Compared with August, our seers have raised their forecasts for 2004 GDP growth in most economies. But their projections for 2005 are split: in ten countries, GDP growth forecasts have been revised up; in ten others they have been revised down. South Korea's economy, for instance, is now expected to grow by 4.1% next year, down from a 4.9% forecast in August.

November

	Real GDP % change		Current account % of GDP	
	2004	2005	2004	2005
China	9.3	7.9	1.7	1.5
Hong Kong	7.6	4.6	9.5	9.4
India	6.3	6.5	0.2	nil
Indonesia	4.7	4.5	1.3	0.5
Malaysia	7.1	5.1	11.8	9.5
Philippines	5.4	4.1	3.4	2.5
Singapore	8.3	4.4	25.3	22.0
South Korea	4.7	4.1	3.5	2.7
Taiwan	5.8	4.3	6.4	6.4
Thailand	6.1	5.2	3.0	2.5
Argentina	7.3	4.2	3.0	1.4
Brazil	4.6	3.7	1.4	0.5
Chile	5.1	4.7	1.9	0.4
Colombia	4.0	3.7	−1.9	−2.6
Mexico	4.0	3.5	−1.7	−1.8
Peru	4.4	4.1	−0.5	−0.8
Venezuela	12.9	3.4	12.4	8.1
Egypt	3.7	4.2	1.8	0.9
Israel	3.3	3.6	−0.4	−0.8
South Africa	2.8	3.3	−2.8	−3.0
Turkey	9.1	5.0	−4.4	−3.9
Czech Republic	3.8	3.8	−5.9	−5.6
Hungary	3.8	3.7	−8.7	−7.9
Poland	5.7	4.9	−1.8	−2.1
Russia	6.7	5.8	7.7	5.3

Sources: ABN Amro; Deutsche Bank; Economist Intelligence Unit; Goldman Sachs; HSBC; ING Financial Markets; J.P.Morgan Chase; Merrill Lynch; Citigroup; UBS Warburg.

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Economy

Nov 11th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.1	Q3	+15.7	Oct	+ 5.2	Sep	+20.3	Sep	+45.9	2003	514.5	Sep
Hong Kong	+12.1	Q2	+ 1.1	Q2	+ 0.7	Sep	−13.8	Sep	+13.6	Q2	119.5	Oct
India	+ 7.4	Q2	+ 7.9	Aug	+ 4.8	Sep	−20.0	Sep	+11.0	Q2	115.7	Oct
Indonesia	+ 4.3	Q2	− 2.3	Aug	+ 6.2	Oct	+25.4	Sep	+ 3.9	Q2	33.6	Sep
Malaysia	+ 8.0	Q2	+ 9.8	Sep	+ 2.1	Oct	+21.1	Sep	+13.6	Q2	56.0	Sep
Philippines	+ 6.2	Q2	− 5.0	Aug	+ 7.1	Oct	− 1.4	Aug	+ 4.5	Jun	12.6	Oct
Singapore	+ 7.7	Q3	+11.8	Sep	+ 2.0	Sep	+16.3	Sep	+28.4	Q2	105.8	Oct
South Korea	+ 5.5	Q2	+ 9.3	Sep	+ 3.8	Oct	+29.3	Oct	+28.0	Sep	178.3	Oct
Taiwan	+ 7.7	Q2	+ 8.1	Sep	+ 2.4	Oct	+ 9.0	Oct	+25.8	Q2	235.0	Oct
Thailand	+ 6.3	Q2	+ 7.7	Sep	+ 3.5	Oct	+ 1.1	Sep	+ 6.7	Sep	43.7	Sep
Argentina	+ 7.0	Q2	+ 6.0	Sep	+ 5.6	Oct	+12.6	Sep	+ 4.6	Q2	18.6	Oct
Brazil	+ 5.7	Q2	+ 7.6	Sep	+ 6.7	Sep	+32.6	Oct	+ 9.8	Sep	49.5	Sep
Chile	+ 5.1	Q2	+12.0	Sep	+ 1.9	Oct	+ 7.9	Oct	+ 1.2	Q2	15.7	Oct
Colombia	+ 4.3	Q2	+ 8.9	Aug	+ 5.9	Oct	+ 0.4	Aug	− 1.6	Q2	12.1	Oct
Mexico	+ 3.9	Q2	+ 5.2	Aug	+ 5.4	Oct	− 4.9	Sep	− 6.7	Q2	62.2	Sep
Peru	+ 6.0	Aug	+ 4.0	Sep	+ 4.0	Oct	+ 2.2	Sep	− 0.7	Q2	11.4	Oct
Venezuela	+13.6	Q2	+27.6	Jul	+19.7	Oct	+20.3	Q2	+14.0	Q2	16.1	Aug
Egypt	+ 4.3	2004†	+ 2.3	2003†	+10.7	Aug‡	− 7.5	Q2	+ 3.7	Q2	13.2	Jul
Israel	+ 2.8	Q2	+12.5	Aug	+ 0.8	Sep	− 6.5	Oct	+ 0.1	Q2	26.1	Oct
South Africa	+ 2.5	Q2	+ 6.1	Sep	+ 1.3	Sep	− 1.1	Sep	− 3.5	Q2	11.3	Oct
Turkey	+13.4	Q2	+ 5.4	Sep	+ 9.9	Oct	−32.1	Sep	−14.0	Sep	34.7	Sep
Czech Republic	+ 4.1	Q2	+ 8.7	Aug	+ 3.5	Oct	− 1.8	Sep	− 6.2	Q2	27.1	Oct
Hungary	+ 4.0	Q2	+ 6.7	Sep	+ 6.6	Sep	− 3.0	Q2	− 8.4	Q2	12.8	Sep
Poland	+ 6.1	Q2	+ 9.3	Sep	+ 4.4	Sep	− 5.1	Aug	− 3.0	Aug	35.3	Sep
Russia	+ 7.4	Q2	+ 3.5	Sep	+11.5	Oct	+78.6	Sep	+44.6	Q3	103.6	Oct
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.9	Q2	+ 5.7	Sep	+ 4.5	Oct	− 2.5	Aug	− 1.5	Q2	1.5	Sep
Latvia	+ 7.7	Q2	+ 6.4	Aug	+ 7.2	Oct	− 2.4	Aug	− 1.4	Aug	1.7	Sep
Lithuania	+ 6.0	Q3	na		+ 3.3	Oct	− 3.2	Aug	− 1.8	Q2	3.3	Sep
Slovakia	+ 5.4	Q2	+ 5.0	Sep	+ 6.6	Oct	− 1.1	Aug	− 1.0	Aug	12.8	Sep
Slovenia	+ 4.6	Q2	+ 3.9	Sep	+ 3.3	Oct	− 0.9	Aug	− 0.2	Aug	7.8	Aug
Pakistan	+ 6.4	2004†	+27.0	Jun	+ 9.0	Sep	− 4.3	Oct	+ 0.8	Q3	10.6	Aug
Saudi Arabia	+ 7.2	2003	na		nil	Sep	+61.2	2003	+29.7	2003	22.2	Aug

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series, % change Jan-Aug annualised.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Nov 11th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 10th		Dec 31st 2003	
	Nov 10th	year ago	Nov 10th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.3	2.75	1,421.8	+2.1	– 9.4	– 9.4
Hong Kong	7.78	7.76	14.4	0.27	13,672.4	+2.1	+ 8.7	+ 8.5
India	45.1	45.3	83.3	5.35	5,973.8	+2.2	+ 2.3	+ 3.5
Indonesia	9,043	8,478	16,693	7.48	918.7	+3.2	+ 32.8	+ 23.7
Malaysia	3.80	3.80	7.01	2.85	882.3	+0.4	+ 11.1	+ 11.1
Philippines	56.4	55.3	104.1	7.44	1,779.2	–2.6	+ 23.4	+ 21.5
Singapore	1.66	1.73	3.06	1.38	2,023.0	+0.3	+ 14.6	+ 17.4
South Korea	1,111	1,173	2,050	3.54	860.5	–0.1	+ 6.1	+ 13.9
Taiwan	33.0	34.0	60.9	1.25	5,948.5	+1.5	+ 1.0	+ 3.9
Thailand	40.7	40.0	75.2	2.15	625.8	–2.4	– 19.0	– 21.2
Argentina	2.97	2.85	5.48	5.19	1,297.2	+0.6	+ 21.0	+ 19.5
Brazil	2.82	2.90	5.21	16.73	23,454.6	–0.9	+ 5.5	+ 7.8
Chile	602	626	1,111	2.16	8,768.3	–0.9	+ 19.5	+ 17.7
Colombia	2,543	2,853	4,694	7.68	4,092.6	+5.5	+ 75.4	+ 91.7
Mexico	11.4	11.1	21.1	8.20	11,794.0	+0.2	+ 34.1	+ 31.8
Peru	3.31	3.48	6.11	2.95	3,589.8	+1.7	+ 47.4	+ 54.3
Venezuela	2,496§	1,598	4,608	12.92	29,413.0	–2.1	+ 32.5	+ 51.3
Egypt	6.20	6.15	11.44	10.56	22,340.2	+3.2	+ 92.0	+ 91.0
Israel	4.42	4.52	8.16	1.00	570.7	+1.1	+ 6.8	+ 6.1
South Africa	6.20	6.87	11.4	7.55	12,207.3	+3.1	+ 17.5	+ 26.6
Turkey	1,459,500	1,481,466	2,694,237	23.08	22,618.0	–3.5	+ 21.4	+ 16.9
Czech Republic	24.3	27.4	44.9	2.62	949.4	+1.5	+ 44.0	+ 52.0
Hungary	190	222	350	10.22	14,193.9	+7.5	+ 51.3	+ 65.6
Poland	3.31	3.92	6.12	6.80	25,521.4	–0.2	+ 22.6	+ 38.5
Russia	28.7	29.9	52.9	13.00	664.9‡	+1.1	+ 15.0	+ 17.2
EMF (MSCI)*	1.00	1.00	1.85	na	491.8	+1.2	+ 11.1	+ 11.1
EMBI+†	1.00	1.00	1.85	na	319.0	–0.5	+ 8.2	+ 8.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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